

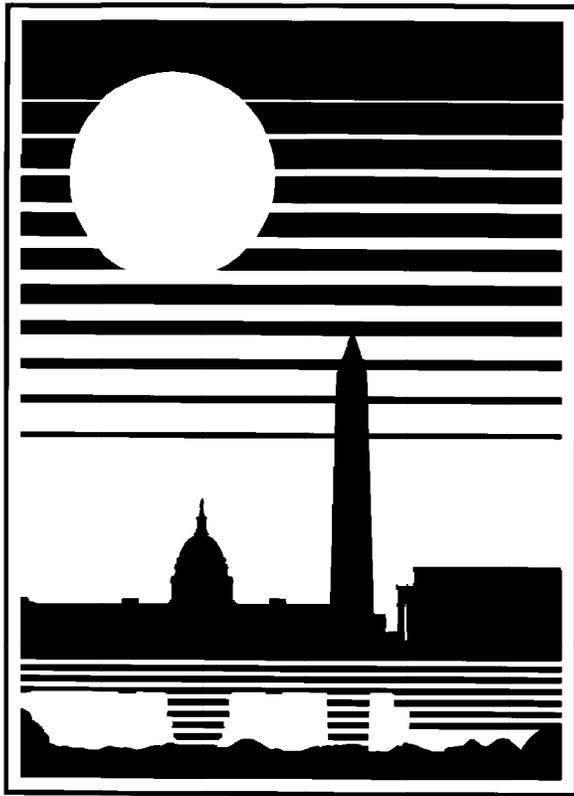


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# Tax Withholding and Estimated Tax



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## Introduction

The federal income tax is a pay-as-you-go tax. You must pay the tax as you earn or receive income during the year. There are two ways to pay as you go:

- **Withholding.** If you are an employee, your employer probably withholds income tax from your pay. Tax may also be withheld

from certain other income — including pensions, bonuses, commissions, and gambling winnings. In each case, the amount withheld is paid to the Internal Revenue Service (IRS) in your name.

- **Estimated tax.** If you do not pay your tax through withholding, or do not pay enough tax that way, you might have to pay estimated tax. People who are in business for themselves generally will have to pay their tax this way. You may have to pay estimated tax if you receive income such as dividends, interest, rents, and royalties. Estimated tax is used to pay not only income tax, but self-employment tax and alternative minimum tax as well.

This publication explains both of these methods. It also explains how to take credit on your 1996 return for the tax that was withheld and for your estimated tax payments.

If you did not pay enough tax during the year either through withholding or by making estimated tax payments, you may have to pay a penalty. The IRS usually can figure this penalty for you. This **underpayment penalty**, and the exceptions to it, are discussed in Chapter 4.

## Important Changes for 1996

You should consider the items in this section when figuring any underpayment penalty for 1996. Figuring the penalty is discussed in Chapter 4.

**Penalty due to new law waived.** You will not have to pay a penalty for underpaying either of the first two installments of 1996 estimated tax if you underpaid because of provisions in the Small Business Job Protection Act of 1996. See Chapter 4.

**Excess social security or railroad retirement tax withholding.** You will have excess social security or tier 1 railroad retirement tax withholding for 1996 only if your wages from two or more employers were more than \$62,700. See *Excess Social Security or Railroad Retirement Tax Withholding* in Chapter 3.

**Penalty rate.** The penalty for underpayment of 1996 estimated tax is figured at an annual rate of 8% for the number of days the underpayment remained unpaid from April 16, 1996, through June 30, 1996, and at a rate of 9% from July 1, 1996, through April 15, 1997.

## Important Changes for 1997

You should consider the items in this section when you figure your estimated tax or how much income tax you want withheld from your pay for 1997. For more information on these and other tax changes, see Publication 553, *Highlights of 1996 Tax Changes*.

**New adoption tax credit.** Beginning in 1997, you may be able to claim a credit for qualified adoption expenses. The credit is limited to \$5,000 for each child (\$6,000 in certain cases for a child with special needs). Depending on your income, the credit may be reduced or eliminated.

**New exclusion for employer-provided adoption assistance payments.** Beginning in 1997, you may not have to include in income certain amounts you received for qualified adoption expenses from your employer's adoption assistance program. This also applies to expenses incurred by your employer under this type of program for your adoption of a child. The amount you do not have to include in income is limited to \$5,000 for each child (\$6,000 in certain cases for a child with special needs). Depending on your income, this amount may be reduced or eliminated.

**Increase in deduction for self-employed health insurance.** The part of your health insurance premiums you can deduct if you are self-employed has increased to 40% for 1997.

**Increase in deduction for spousal IRAs.** If certain requirements are met, you may contribute as much as \$2,000 to your IRA and as much as another \$2,000 to a spousal IRA. Some or all of these amounts may be deductible. For 1996, the total amount you could contribute and deduct to both was limited to \$2,250.

**Medical expenses for long-term care.** Beginning in 1997, you generally can include in your medical expenses the costs of qualified long-term care services. You can also include premiums for qualified long-term care insurance, but only up to certain limits.

**Long-term care insurance.** Beginning in 1997, amounts your employer pays to provide you with qualified long-term care insurance are not taxed to you, unless the coverage is through a flexible spending or similar arrangement.

Benefits you receive under a qualified long-term care insurance contract generally are not taxed. But, in some cases, the amount not taxed is limited.

**Medical savings accounts.** You may be able to deduct up to \$1,462.50 (\$3,375 for family coverage) a year for contributions to a medical savings account in 1997, even if you do not itemize your deductions. You must be covered under a high deductible health plan and meet certain other requirements.

**Deduction for donation of appreciated stock to private foundation.** The special rule allowing a deduction for the full fair market value of qualified appreciated stock given to certain private foundations will not apply to contributions made after May 31, 1997.

**SIMPLE retirement plans.** Beginning in 1997, your employer may be eligible to adopt a Savings Incentive Match Plan for Employees

(SIMPLE) retirement plan. If your employer establishes a SIMPLE plan for 1997, you may be able to have your employer contribute a certain percentage of your compensation to the plan each pay period (totaling up to \$6,000 for 1997). Your employer must make a matching contribution on your behalf. You do not have to pay income tax on these contributions or on the plan's earnings until they are distributed. Self-employed individuals can also participate in a SIMPLE plan.

**Accelerated death benefits not taxed.** Beginning in 1997, certain payments received under a life insurance contract on the life of a terminally or chronically ill individual before the individual's death (accelerated death benefits) are not taxed if certain requirements are met. The tax-free amount is limited in some cases. Amounts received for the sale or assignment of these benefits to certain qualified viatical settlement providers are also tax-free, subject to a limit in some cases.

**Changes to business-related provisions.** A number of changes in the law affect businesses for 1997. These include:

- 1) An increase in the maximum section 179 deduction to \$18,000 (from \$17,500 in 1996).
- 2) A new work opportunity tax credit that is 35% of the qualified first-year wages, generally up to \$6,000, paid or incurred during the year to certain members of targeted groups who begin working for you after September 30, 1996, and before October 1, 1997.
- 3) An extension of the credit for increasing certain research activities, generally for amounts paid or incurred after June 30, 1996, and before June 1, 1997. (But you cannot use the extension of this credit when figuring your 1997 estimated tax.)

**Personal exemption.** For 1997, the personal exemption amount for you, your spouse, and each dependent has increased to \$2,650.

**Phaseout of personal exemptions.** Your deduction for personal exemptions is reduced by 2% for each \$2,500 (\$1,250 if you are married filing separately), or part of that amount, by which your adjusted gross income is more than an amount based on your filing status. The amounts for 1997 are:

Single	\$121,200
Married filing jointly or qualifying widow(er)	\$181,800
Married filing separately	\$ 90,900
Head of household	\$151,500

**Standard deduction.** Individuals who do not itemize deductions have an increased standard deduction for 1997. See the *1997 Standard Deduction Tables* at the end of Chapter 2.

**Reduction of itemized deductions.** For 1997, certain itemized deductions are reduced

by 3% of the amount of your adjusted gross income that is more than \$121,200 (\$60,600 if you are married filing separately). The reduction cannot be more than 80% of your affected deductions. Itemized deductions subject to the reduction are those other than medical expenses, investment interest, casualty and theft losses, or gambling losses. This reduction does not apply when computing alternative minimum tax, nor does it apply to estates or trusts.

**Self-employment tax.** For 1997, the social security (old-age, survivor, and disability insurance) part of the self-employment tax is

12.4% of up to \$65,400 of net earnings. The Medicare (hospital insurance) part of the tax is 2.9% of all net earnings.

# Tax Withholding for 1997

## Important Changes for 1997

**Unemployment compensation.** Beginning in 1997, you can choose to have income tax withheld from any unemployment compensation you get. See *Unemployment Compensation*, later in this chapter, for more information.

**Social security and other federal payments.** Beginning in 1997, you can choose to have income tax withheld from certain federal payments you get. These payments include social security benefits and tier 1 railroad retirement benefits. For more information, see *Social Security and Other Federal Payments*, later in this chapter.

## Important Reminder

**Employment taxes on household employees.** If you are otherwise subject to tax withholding, you have the option of including any expected employment (social security, Medicare, and federal unemployment) taxes for these employees when figuring how much you want withheld from your pay for 1997.

## Introduction

This chapter discusses withholding on these types of income:

- Salaries and wages
- Tips
- Taxable fringe benefits
- Sick pay
- Pensions and annuities
- Gambling winnings
- Unemployment compensation
- Social security and other federal payments.

This chapter explains in detail the rules for withholding tax from each of these types of income. The discussion of salaries and wages includes an explanation of how to complete a Form W-4.

This chapter also covers backup withholding on interest, dividends, and other payments.

### Useful Items

You may want to see:

#### Publication

- 525** Taxable and Nontaxable Income

- 919** Is My Withholding Correct for 1997?

### Form (and Instructions)

- W-4** Employee's Withholding Allowance Certificate
- W-4P** Withholding Certificate for Pension or Annuity Payments
- W-4S** Request for Federal Income Tax Withholding From Sick Pay
- W-4V** Voluntary Withholding Request

See Chapter 5 of this publication for information about getting these publications and forms.

## Salaries and Wages

Income tax is withheld from the pay of most employees. Your pay includes bonuses, commissions, and vacation allowances, in addition to your regular pay. It also includes reimbursements and other expense allowances paid under a nonaccountable plan. See *Supplemental Wages*, later.

**Military retirees.** Military retirement pay is treated in the same manner as regular pay for income tax withholding purposes, even though it is treated as a pension or annuity for other tax purposes.

**Household workers.** If you are a household worker, you can ask your employer to withhold income tax from your pay. Tax is withheld only if you want it withheld and your employer agrees to withhold it. If you do not have enough income tax withheld, you may have to make estimated tax payments, as discussed in Chapter 2.

**Farmworkers.** Income tax is generally withheld from your cash wages for work on a farm unless your employer:

- 1) Pays you cash wages of less than \$150 during the year, and
- 2) Has expenditures for agricultural labor totaling less than \$2,500 during the year.

If you receive either cash wages not subject to withholding or noncash wages, you can ask your employer to withhold income tax. If your employer does not agree to withhold tax, or if not enough is withheld, you may have to make estimated tax payments, as discussed in Chapter 2.

## Determining Amount of Tax Withheld

The amount of income tax your employer withholds from your regular pay depends on two things:

- 1) The amount you earn, and
- 2) The information you give your employer on **Form W-4, Employee's Withholding Allowance Certificate**.

Form W-4 includes three types of information that your employer will use to figure your withholding:

- 1) Whether to withhold at the single rate or at the lower married rate,
- 2) How many withholding allowances you claim (each allowance reduces the amount withheld), and
- 3) Whether you want an additional amount withheld.

If your income is low enough that you will not have to pay income tax for the year, you may be exempt from withholding. See *Exemption From Withholding*, later.

**Note.** You must specify a filing status and a number of withholding allowances on Form W-4. You cannot specify only a dollar amount of withholding.

**New job.** When you start a new job, you must fill out a Form W-4 and give it to your employer. Your employer should have copies of the form. If you later need to change the information you gave, you must fill out a new form.

If you work only part of the year (for example, you start working after the beginning of the year), too much tax may be withheld. You may be able to avoid overwithholding if your employer agrees to use the part-year method, explained later.

**Changing your withholding.** Events during the year may change your marital status or the exemptions, adjustments, deductions, or credits you expect to claim on your return. When this happens, you may need to give your employer a new Form W-4 to change your withholding status or number of allowances.

You **must** give your employer a new Form W-4 within 10 days after:

- 1) Your divorce, if you have been claiming married status, or
- 2) Any event that decreases the number of withholding allowances you can claim.

Events that decrease the number of withholding allowances you can claim include the following.

- 1) You have been claiming an allowance for your spouse, but you get divorced or your spouse begins claiming his or her own allowance on a separate Form W-4.
- 2) You have been claiming an allowance for a dependent, but you no longer expect to provide more than half the dependent's support for the year.
- 3) You have been claiming an allowance for your child, but you now find that he or she will earn more than \$2,650 during the year. In addition, he or she will be:
  - a) 24 or older by the end of the year, or
  - b) 19 or older by the end of the year and will not qualify as a student.
- 4) You have been claiming allowances for your expected deductions, but you now

find that they will be less than you expected.

Generally, you can submit a new Form W-4 at any time you wish to change the number of your withholding allowances for any other reason.

If you change the number of your withholding allowances, you can request that your employer withhold using the cumulative wage method, explained later.

**Changing your withholding for 1998.** If events in 1997 will decrease the number of your withholding allowances for 1998, you must give your employer a new Form W-4 by December 1, 1997. If an event occurs in December 1997, submit a new Form W-4 within 10 days. Events that decrease the number of your allowances for 1998 include the following.

- 1) You claimed allowances for 1997 based on child care expenses, moving expenses, or large medical expenses, but you will not have these expenses in 1998.
- 2) You have been claiming an allowance for your spouse, but he or she died in 1997. Because you can still file a joint return for 1997, this will not affect the number of your withholding allowances until 1998. You will also have to change from married to single status for 1998, unless you can file as a qualifying widow or widower because you have a dependent child. You must file a new Form W-4 showing single status by December 1 of the last year you are eligible to file as qualifying widow or widower.

**Part-year method.** If you work only part of the year and your employer agrees to use the part-year withholding method, less tax will be withheld from each wage payment than would be withheld if you worked all year. To be eligible for the part-year method, you must meet both the following requirements.

- 1) **You must use the calendar year** (the 12 months from January 1 through December 31) as your tax year. You cannot use a fiscal year.
- 2) **You must not expect to be employed for more than 245 days during the year.** To figure this limit, count all calendar days that you are employed, including weekends, vacations, and sick days, beginning the first day you are on the job for pay and ending your last day of work. If you are temporarily laid off for 30 days or less, count those days too. If you are laid off for more than 30 days, do not count those days. You will not meet this requirement if you begin working before May 1 and expect to work for the rest of the year.

**How to apply for the part-year method.**

You must ask in writing that your employer use this method. The request must state all of the following.

- 1) The date of your last day of work for any prior employer during the current calendar year.
- 2) That you do not expect to be employed more than 245 days during the current calendar year.
- 3) That you use the calendar year as your tax year.

**Cumulative wage method.** If you change the number of your withholding allowances during the year, too much or too little tax may have been withheld for the period before you made the change. You may be able to compensate for this if your employer agrees to use the cumulative wage withholding method for the rest of the year. You must ask in writing that your employer use this method.

To be eligible, you must have been paid for the same kind of payroll period (weekly, bi-weekly, etc.) since the beginning of the year.

**Checking your withholding.** After you have given your employer a Form W-4, you can check to see whether the amount of tax withheld from your pay is too little or too much. See *Getting the Right Amount of Tax Withheld*, later. If too much or too little tax is being withheld, you should give your employer a new Form W-4 to change your withholding.

**Note.** You cannot give your employer a payment to cover withholding for past pay periods. Nor can you give your employer a payment for estimated tax.

## Completing Form W-4 and Worksheets

The discussion that follows explains in detail how to fill out Form W-4. It has more detailed information about some topics than the Form W-4 instructions.

In reading this discussion, you may find it helpful to refer to the filled-in Form W-4 in *Example 1.3*, later in this chapter.

### Marital Status (Line 3 of Form W-4)

There is a lower withholding rate for married people who can use the tax rates for joint returns. Everyone else must have tax withheld at the higher single rate. (Also, see *Getting the Right Amount of Tax Withheld*, later.)

You must claim **single** status if either of the following applies.

- 1) **You are single.** If you are divorced, or separated from your spouse under a court decree of separate maintenance, you are considered single.
- 2) **You are married, but you are neither a citizen nor a resident of the United States,** or your spouse is neither a citizen nor a resident of the United States. However, if one of you is a citizen or a resident, you can choose to have the other treated as a resident. You can then file a joint return and claim married status on your Form W-4. See *Nonresident Spouse*

*Treated as a Resident* in Chapter 1 of Publication 519, *U.S. Tax Guide for Aliens*, for more information.

You can claim **married** status if either of the following applies.

- 1) **You are married and neither you nor your spouse is a nonresident alien.** You are considered married for the whole year even if your spouse died during the year.
- 2) **You expect to be able to file your return as a qualifying widow or widower.** You usually can use this filing status if your spouse died within the previous 2 years and you provide a home for your dependent child. However, you must file a new Form W-4 showing your filing status as single by December 1 of the last year you are eligible to file as a qualifying widow or widower. For more information, see *Qualifying Widow(er) With Dependent Child* under *Filing Status* in Publication 501.

Some married people find that they do not have enough tax withheld at the married rate. This can happen, for example, when both spouses work. To avoid this, you can choose to have tax withheld at the higher single rate (even if you qualify for the married rate). Also, you can fill out the *Two-Earner/Two-Job Worksheet*, explained later.

### Withholding Allowances (Line 5 of Form W-4)

The more allowances you claim on Form W-4, the less income tax your employer will withhold. You will have the most tax withheld if you claim "0" allowances. The number of allowances you can claim depends on:

- 1) How many exemptions you can take on your tax return,
- 2) Whether you have income from more than one job,
- 3) What deductions, adjustments to income, and credits you expect to have for the year, and
- 4) Whether you will file as head of household.

If you are married, it also depends on whether your spouse also works and claims any allowances on his or her own Form W-4. If you both work, you should figure your combined allowances on one Form W-4 worksheet. You then should divide the allowances among the Forms W-4 you each file with every employer. See *Two jobs*, later.

**Form W-4 worksheets.** Form W-4 has worksheets to help you figure how many withholding allowances you can claim. The worksheets are for your own records. Do not give them to your employer.

Complete only one set of Form W-4 worksheets, no matter how many jobs you have. If you are married and will file a joint return, complete only one set of worksheets for you and your spouse, even if you both earn wages and

must each give a Form W-4 to your employer. Complete separate sets of worksheets only if you and your spouse will file separate returns.

If you are not exempt from withholding (see *Exemption From Withholding*, later), complete the Personal Allowances Worksheet on page 1 of the form. You should also use the worksheets on page 2 of the form to adjust the number of your withholding allowances for itemized deductions and adjustments to income, and for two-earner or two-job situations. If you want to adjust the number of your withholding allowances for certain tax credits, use the Deductions and Adjustments Worksheet on page 2 of the form even if you do not have any deductions or adjustments.

For accuracy, complete all worksheets that apply to your situation. The worksheets will help you figure the maximum number of withholding allowances you are entitled to claim so that the amount of income tax withheld from your wages will match, as closely as possible, the amount of income tax you will owe at the end of the year.

**Alternative method of figuring withholding allowances.** You can take into account most items of income, adjustments to income, deductions, and tax credits in figuring the number of your withholding allowances. Because the Form W-4 worksheets use a simplified method to take these items into account, they do not always result in withholding that is exactly equal to the tax you will owe. You do not have to use the worksheets if you use a more accurate method of figuring the number of withholding allowances.

The method you use must be based on withholding schedules, the tax rate schedules, and the worksheet for Form 1040-ES, *Estimated Tax for Individuals*. (See *How To Figure Estimated Tax* in Chapter 2.) It must take into account only the items of income, adjustments to income, deductions, and tax credits that are taken into account on Form W-4.

You can use the number of withholding allowances determined under this alternative method rather than the number determined using the Form W-4 worksheets. You must still give your employer a Form W-4 claiming your withholding allowances.

**Two jobs.** If you have income from two jobs at the same time, complete only one set of Form W-4 worksheets. Then split your allowances between the Forms W-4 for each job. You cannot claim the same allowances with more than one employer at the same time. You can claim all your allowances with one employer and none with the other, or divide them in any other way you wish.

**Married individuals.** If both you and your spouse are employed and you expect to file a joint return, figure your withholding allowances using your combined income, adjustments, deductions, exemptions, and credits. Use only one set of worksheets. You can divide your total allowances in any way you wish, but you cannot claim an allowance that your spouse also claims.

If you and your spouse expect to file separate returns, figure your allowances separately

based on your own individual income, adjustments, deductions, exemptions, and credits.

**Employees who are not citizens or residents.** If you are neither a citizen nor a resident of the United States, you usually can claim only one withholding allowance. This rule does not apply if you are a resident of Canada or Mexico, or if you are a U.S. national. It also does not apply if your spouse is a U.S. citizen or resident and you have chosen to be treated as a resident of the United States. Special rules apply to residents of Korea, Japan and India. For more information, see *Withholding from Compensation* in Chapter 8 of Publication 519, *U.S. Tax Guide for Aliens*.

### Personal Allowances Worksheet

Use the Personal Allowances Worksheet on page 1 of Form W-4 to figure your withholding allowances for all of the following that apply:

- Exemptions
- Only one job
- Head of household status
- Child and dependent care credit

### Exemptions (worksheet lines A, C, and D).

You can claim one withholding allowance for each exemption you expect to claim on your tax return.

**Self.** You can claim one allowance for your exemption on line A unless you can be claimed as a dependent on another person's tax return. If another person is entitled to claim you as a dependent, you cannot claim an allowance for your exemption even if the other person will not claim your exemption or the exemption will be reduced or eliminated under the phaseout rule.

**Spouse.** You can claim an allowance for your spouse's exemption on line C unless your spouse can be claimed as a dependent on another person's tax return. But do not claim this allowance if you and your spouse expect to file separate returns.

**Dependents.** You can claim one allowance on line D for each exemption you will claim for a dependent on your tax return.

**Phaseout.** For 1997, your deduction for personal exemptions is phased out if your adjusted gross income (AGI) falls within the following brackets.

Table 1.1

Single	\$121,200 – \$243,700
Married filing jointly or qualifying widow(er)	\$181,800 – \$304,300
Married filing separately	\$ 90,900 – \$152,150
Head of household	\$151,500 – \$274,000



If you expect your AGI to be more than the highest amount in the above bracket for your filing status, enter “-0-” on lines A, C, and D. If your AGI will fall within the bracket, use the following worksheet to figure the total allowances for those lines.

### Worksheet 1.1

1. Enter your expected AGI .....
2. Enter:
  - \$121,200 if single
  - \$181,800 if married filing jointly or qualifying widow(er)
  - \$90,900 if married filing separately
  - \$151,500 if head of household ....
3. Subtract line 2 from line 1 .....
4. Divide the amount on line 3 by \$125,000 (\$62,500 if married filing separately). Enter the result as a decimal .....
5. Enter the number of allowances on lines A, C, and D of the Personal Allowances Worksheet without regard to the phaseout rule .....
6. Multiply line 4 by line 5. If the result is not a whole number, increase it to the next higher whole number .....
7. Subtract line 6 from line 5. This is the maximum number you should enter on lines A, C, and D of the Personal Allowances Worksheet .....

**Only one job (worksheet line B).** You can claim an additional withholding allowance if any of the following apply.

- 1) You are single, and you have only one job at a time.
- 2) You are married, you have only one job at a time, and your spouse does not work.
- 3) Your wages from a second job or your spouse's wages (or the total of both) are \$1,000 or less.

If you qualify for this allowance, enter “1” on line B of the worksheet.

**Head of household (worksheet line E).** You can file as head of household on your tax return if you are unmarried and pay more than half the cost of keeping up a home for yourself and your dependent or other qualifying individual. For more information, see *Head of Household under Filing Status* in Publication 501.

If you expect to file as head of household on your 1997 tax return, enter “1” on line E of the worksheet.

**Child and dependent care credit (worksheet line F).** Enter “1” on line F if you expect to have at least \$1,500 of qualifying child or dependent care expenses that you plan to claim a credit for on your 1997 return. Generally, qualifying expenses are those you pay for the care of your dependent who is under 13, your disabled dependent, or your disabled spouse so that you can work or look for work. For more information, get Publication 503, *Child and Dependent Care Expenses*.

Instead of using line F, you can choose to take the credit into account on line 5 of the Deductions and Adjustments Worksheet, as explained later under *Tax credits*.

**Total personal allowances (worksheet line G).** Add lines A through F and enter the total on line G. If you do not adjust the number of your withholding allowances for itemized deductions or adjustments to income, or for two-earner or two-job situations, enter the number from line G on line 5 of Form W-4.

## Deductions and Adjustments Worksheet

Fill out this worksheet to adjust the number of your withholding allowances for deductions, adjustments to income, and tax credits. Use the amount of each item you can reasonably expect to show on your 1997 return. However, do not use more than:

- 1) The amount shown for that item on your 1996 return (or your 1995 return if you have not yet filed your 1996 return), plus
- 2) Any additional amount related to a transaction or occurrence (such as the signing of an agreement or the sale of property) that you can prove has happened or will happen during 1996 or 1997.

Do not include any amount shown on your last tax return if that amount has been disallowed by the IRS.

**Example 1.1.** On June 30, 1996, you bought your first home. On your 1996 tax return you claimed itemized deductions of \$6,600, the total mortgage interest and real estate tax you paid during the 6 months you owned your home. Based on your mortgage payment schedule and your real estate tax assessment, you can reasonably expect to claim deductions of \$13,200 for those items on your 1997 return. You can use \$13,200 to figure the number of your withholding allowances for itemized deductions.

**Not itemizing deductions.** If you expect to claim the standard deduction on your tax return, skip lines 1 and 2, and enter “-0-” on line 3 of the worksheet.

### Itemized deductions (worksheet line 1).

You can take the following deductions into account when figuring additional withholding allowances for 1997. You normally claim these deductions on Schedule A of Form 1040.

- 1) Medical and dental expenses that are more than 7.5% of your 1997 **adjusted gross income** (defined later).
- 2) State and local income taxes and property taxes.
- 3) Deductible home mortgage interest.
- 4) Investment interest up to net investment income.
- 5) Charitable contributions.
- 6) Casualty and theft losses that are more than 10% of your 1997 adjusted gross income.
- 7) Fully deductible miscellaneous deductions, including:
  - a) Impairment-related work expenses of persons with disabilities,

- b) Federal estate tax on income in respect of a decedent,
  - c) Repayment of more than \$3,000 of income held under a claim of right (that you included in income in an earlier year because at the time you thought you had an unrestricted right to it),
  - d) Unrecovered investments in an annuity contract under which payments have ceased because of the annuitant's death, and
  - e) Gambling losses (up to the amount of gambling winnings reported on your return).
- 8) Other miscellaneous deductions that are more than 2% of your 1997 AGI, including:
- a) Unreimbursed employee business expenses, such as educational expenses, work clothes and uniforms, union dues and fees, and the cost of work-related small tools and supplies,
  - b) Safe deposit box rental,
  - c) Tax counsel and assistance, and
  - d) Fees paid to an IRA custodian.

**Adjusted gross income** for purposes of the worksheet is your estimated total income for 1997 minus any estimated adjustments to income (discussed later) that you include on line 4 of the worksheet.

Enter your estimated total itemized deductions on line 1 of the worksheet.



### Reduction of itemized deductions.

For 1997, your total itemized deductions may be reduced if your adjusted gross income (AGI) is more than \$121,200 (\$60,600 if married filing separately). If you expect your AGI to be more than that amount, use the following worksheet to figure the amount to enter on line 1 of the Deductions and Adjustments Worksheet.

#### Worksheet 1.2

1. Enter the estimated total of your itemized deductions .....
  2. Enter the amount included in line 1 for medical and dental expenses, investment interest, casualty or theft losses, and gambling losses .....
  3. Subtract line 2 from line 1 .....
- Note.** If the amount on line 3 is zero, stop here and enter the amount from line 1 of this worksheet on line 1 of the Deductions and Adjustments Worksheet.
4. Multiply the amount on line 3 by .80 .....
  5. Enter your expected AGI .....
  6. Enter \$121,200 (\$60,600 if married filing separately) .....
  7. Subtract line 6 from line 5 .....
  8. Multiply the amount on line 7 by .03 .....
  9. Enter the smaller of line 4 or line 8 .....

10. Subtract line 9 from line 1. Enter the result here and on line 1 of the Deductions and Adjustments Worksheet .....

### Standard deduction (worksheet line 2).

Enter on line 2 the standard deduction shown for your filing status. Subtract line 2 from line 1 and enter the result on line 3.

**If line 2 is more than line 1,** enter “-0-” on line 3.

### Adjustments to income (worksheet line 4).

You can take the following adjustments to income into account when figuring additional withholding allowances for 1997. These adjustments appear on page 1 of your Form 1040 or 1040A.

- IRA contributions
- Deduction for one-half of self-employment tax
- Deduction for 40% of self-employed health insurance
- Contributions to a retirement plan for self-employed individuals (Keogh plan or SEP)
- Contributions to a medical savings account
- Penalty on early withdrawal of savings
- Alimony payments
- Certain moving expenses
- Net losses from Schedules C, D, E, and F of Form 1040 and from Part II of Form 4797, line 20b(2)
- Net operating loss carryovers

Enter your estimated total adjustments to income on line 4 of the worksheet. Add lines 3 and 4 and enter the result on line 5.

**Tax credits.** Although you can take most tax credits into account when figuring withholding allowances, the Form W-4 worksheets use only the child and dependent care credit (line F of the Personal Allowances Worksheet). But you can take that credit and others into account by adding an extra amount on line 5 of the Deductions and Adjustments Worksheet.

If you take the child and dependent care credit into account on line 5, do **not** use line F of the Personal Allowances Worksheet.

In addition to the child and dependent care credit, you can take into account the following credits:

- 1) Credit for the elderly or the disabled (see Publication 524, *Credit for the Elderly or the Disabled*),
- 2) Mortgage interest credit (see *Mortgage Interest Credit* in Publication 530, *Tax Information for First-Time Homeowners*),
- 3) Foreign tax credit, except any credit that applies to wages not subject to U.S. income tax withholding because they are subject to income tax withholding by a foreign country (see Publication 514, *Foreign Tax Credit for Individuals*),
- 4) Qualified electric vehicle credit (see Form 8834 instructions),

- 5) Credit for prior year minimum tax if you paid alternative minimum tax in an earlier year (see Form 8801 instructions),
- 6) Earned income credit, unless you requested advance payment of the credit (see Publication 596, *Earned Income Credit*),
- 7) Adoption credit (see Publication 553, *Highlights of 1996 Tax Changes*), and
- 8) General business credit.

To figure the amount to add on line 5 for tax credits, multiply your estimated total credits by the appropriate number from the following tables.

**Table 1.2**

**Credit Table A  
Married Filing Jointly  
or Qualifying Widow(er)**

If combined estimated wages are:	Multiply credits by:
\$0 to 56,000	6.7
56,001 to 114,000	3.6
114,001 to 167,000	3.2
167,001 to 286,000	2.8
over 286,000	2.5

**Credit Table B  
Single**

If estimated wages are:	Multiply credits by:
\$0 to 31,000	6.7
31,001 to 67,000	3.6
67,001 to 131,000	3.2
131,001 to 278,000	2.8
over 278,000	2.5

**Credit Table C  
Head of Household**

If estimated wages are:	Multiply credits by:
\$0 to 44,000	6.7
44,001 to 97,000	3.6
97,001 to 150,000	3.2
150,001 to 282,000	2.8
over 282,000	2.5

**Credit Table D  
Married Filing Separately**

If estimated wages are:	Multiply credits by:
\$0 to 27,000	6.7
27,001 to 56,000	3.6
56,001 to 82,000	3.2
82,001 to 142,000	2.8
over 142,000	2.5

**Example 1.2.** You are married and expect to file a joint return for 1997. Your combined estimated wages are \$65,000. Your combined tax credits include a child and dependent care credit of \$960 and a mortgage interest credit of \$1,700.

In Credit Table A, the number for your combined estimated wages (\$56,001 to \$114,000) is 3.6. Multiply your total estimated tax credits of \$2,660 (\$960 + \$1,700) by 3.6. Add the result, \$9,576, to the amount you would otherwise show on line 5 of the Deductions and Adjustments Worksheet and enter the total on line 5. Because you choose to account for your child and dependent care credit this way, you cannot use line F of the Personal Allowances Worksheet.

**Nonwage income (worksheet line 6).** Enter on line 6 your estimated total nonwage income (other than tax-exempt income).

**Nonwage income.** This includes interest, dividends, net rental income, unemployment compensation, alimony received, gambling winnings, prizes and awards, hobby income, capital gains, royalties, and partnership income.

**Net deductions and adjustments (worksheet line 7).** Subtract line 6 from line 5 and enter the result (but not less than zero) on line 7. If line 6 is more than line 5, you may not have enough income tax withheld from your wages. See *Getting the Right Amount of Tax Withheld*, later.

If line 7 is less than \$2,500, enter "0" on line 8. If line 7 is \$2,500 or more, divide it by \$2,500, drop any fraction, and enter the result on line 8.

On line 9, enter the number from line G of the Personal Allowances Worksheet.

**Total withholding allowances (worksheet line 10).** Add lines 8 and 9 and enter the result on line 10. If you do not need to adjust your withholding based on a two-earner or two-job situation, enter the number from line 10 on line 5 of Form W-4.

### Two-Earner/Two-Job Worksheet

You should complete this worksheet if any of the following situations apply.

- 1) You are **single** or **married filing separately**, you have more than one job, and your combined earnings from all jobs exceed \$30,000.
- 2) You are **married filing jointly**, you have a working spouse or more than one job, and

your combined earnings from all jobs exceed \$50,000.

- 3) You expect to owe an amount other than income tax, such as self-employment tax.

If only (3) applies, skip lines 1 through 7 and see *Other amounts owed*, later.



*If you use this worksheet and your earnings exceed \$150,000 if you are single, or \$200,000 if you are married, see Publication 919, Is My Withholding Correct for 1997? to check that you are having enough tax withheld.*

**Reducing your allowances (worksheet lines 1 – 3).** On line 1 of the worksheet, enter the number from line G of the Personal Allowances Worksheet (or line 10 of the Deductions and Adjustments Worksheet, if used). Using Table 1 on the Form W-4, find the number listed beside the amount of your estimated wages for the year from your **lowest** paying job (or if lower, your spouse's job). Enter that number on line 2.

Subtract line 2 from line 1 and enter the result (but not less than zero) on line 3 and on Form W-4, line 5. If line 1 is greater than or equal to line 2, do not use the rest of the worksheet (or skip to line 8 if you expect to owe amounts other than income tax).

If line 1 is less than line 2, you should complete lines 4 through 9 of the worksheet to figure the additional withholding needed to avoid underwithholding.

**Additional withholding (worksheet lines 4 – 9).** If line 1 is less than line 2, enter the number from line 2 on line 4 and the number from line 1 on line 5. Subtract line 5 from line 4 and enter the result on line 6.

**Annual amount.** Using Table 2 on the Form W-4, find the number listed beside the amount of your estimated wages for the year from your **highest** paying job (or if higher, your spouse's job). Enter that number on line 7. Multiply line 7 by line 6 and enter the result on line 8. If you do not expect to owe amounts other than income tax, this is the additional withholding needed for the year.

**Other amounts owed.** If you expect to owe amounts other than income tax, such as self-employment tax, include them on line 8. The total is the additional withholding needed for the year.

**Additional withholding each payday.** Divide line 8 by the number of paydays remaining in 1997. (For example, if you are paid every other week and you have had 5 paydays this year, divide by 21.) Enter the result on line 9 of the worksheet and on Form W-4, line 6. This is the additional amount you want withheld each payday.

### Example 1.3

Joyce Green works in a bookstore and expects to earn about \$13,300 in 1997. Her husband, John, works full time at the Acme Corporation, where his expected pay for 1997 is \$37,500. They file a joint income tax return

and claim their two young children as dependents. Because they file jointly, they use only one set of Form W-4 worksheets to figure the number of withholding allowances. The Greens' worksheets and John's W-4 are shown in this chapter.

**Personal Allowances Worksheet.** On this worksheet, John and Joyce claim allowances for themselves and their children by entering "4" on line A, "1" on line C, and "2" on line D. Because both John and Joyce will receive wages of more than \$1,000, they are not entitled to the additional withholding allowance on line B. The Greens expect to have child and dependent care expenses of \$2,400. They enter "1" on line F of the worksheet.

They enter their total personal allowances, 5, on line G.

**Deductions and Adjustments Worksheet.** Because they plan to itemize deductions and claim adjustments to income, the Greens use this worksheet to see whether they are entitled to additional allowances.

The Greens' estimated itemized deductions total \$11,200, which they enter on line 1 of the worksheet. Because they will file a joint return, they enter \$6,900 on line 2. They subtract \$6,900 from \$11,200 and enter the result, \$4,300, on line 3.

The Greens expect to have an adjustment to income of \$3,000 for their deductible IRA contributions. They do not expect to have any other adjustments to income. They enter \$3,000 on line 4.

The Greens add line 3 and line 4 and enter the total, \$7,300, on line 5.

Joyce and John expect to receive \$600 in interest and dividend income during the year. They enter \$600 on line 6 and subtract line 6 from line 5. They enter the result, \$6,700, on line 7. They divide line 7 by \$2,500, and drop the fraction to determine their additional allowances. They enter "2" on line 8.

The Greens enter "5" (the number from line G of the Personal Allowances Worksheet) on line 9 and add it to line 8. They enter "7" on line 10.

**Two-Earner/Two-Job Worksheet.** The Greens use this worksheet because they both work and together earn over \$50,000. They enter "7" (the number from line 10 of the Deductions and Adjustments Worksheet) on line 1.

Next, they use Table 1 on the Form W-4 to find the number to enter on line 2 of the worksheet. Because they will file a joint return and their expected wages from their lowest paying job are \$13,300, they enter "3" on line 2. They subtract line 2 from line 1 and enter "4" on line 3 and on Form W-4, line 5.

John and Joyce Green can take a total of four withholding allowances between them. They decide that John will take all four allowances on his Form W-4. Joyce, therefore, cannot claim any allowances on hers. She will enter "0" on line 5 of the Form W-4 she gives to her employer.

## Getting the Right Amount of Tax Withheld

In most situations, the tax withheld from your pay will be close to the tax you figure on your return if:

- 1) You accurately complete all the Form W-4 worksheets that apply to you, and
- 2) You give your employer a new Form W-4 when changes occur.

But because the worksheets and withholding methods do not account for all possible situations, you may not be getting the right amount withheld. This is most likely to happen in the following situations.

- 1) You are married and both you and your spouse work.
- 2) You have more than one job at a time.
- 3) You have nonwage income, such as interest, dividends, alimony, unemployment compensation, or self-employment income.
- 4) You will owe additional amounts with your return, such as self-employment tax.
- 5) Your withholding is based on obsolete Form W-4 information for a substantial part of the year.
- 6) Your earnings are more than \$150,000 if you are single or \$200,000 if you are married.

To make sure you are getting the right amount of tax withheld, get Publication 919, *Is My Withholding Correct for 1997?* It will help you compare the total tax to be withheld during the year with the tax you can expect to figure on your return. It also will help you determine how much, if any, additional withholding is needed each payday to avoid owing tax when you file your return. If you do not have enough tax withheld, you may have to make estimated tax payments. See Chapter 2 for information about estimated tax.

## Rules Your Employer Must Follow

It may be helpful for you to know some of the withholding rules your employer must follow. These rules can affect how you fill out your Form W-4 and how you handle problems that may arise.

**New Form W-4.** When you start a new job, your employer should give you a Form W-4 to fill out. Your employer will use the information you give on the form to figure your withholding beginning with your first payday.

If you later fill out a new Form W-4, your employer can put it into effect as soon as it is practical to do so. The deadline for putting it into effect is the start of the first payroll period ending 30 or more days after you turn it in.

**No Form W-4.** If you do not give your employer a completed Form W-4, your employer must withhold at the highest rate—as if you were single and claimed no allowances.

**Repaying withheld tax.** If you find you are having too much tax withheld because you did not claim all the withholding allowances you are entitled to, you should give your employer a new Form W-4. Your employer cannot repay you any of the tax withheld under your old Form W-4.

However, if your employer has withheld more than the correct amount of tax for the Form W-4 you have in effect, you do not have to fill out a new Form W-4 to have your withholding lowered to the correct amount. Your employer can repay you the amount that was incorrectly withheld. If you are not repaid, you will receive credit on your tax return for the full amount actually withheld.

**Sending your Form W-4 to the IRS.** Your employer will usually keep your Form W-4 and use it to figure your withholding. Under normal circumstances, it will not be sent to the IRS. However, your employer must send a copy of your Form W-4 to the IRS for verification in both of the following situations.

- 1) You claim more than 10 withholding allowances.
- 2) You claim exemption from withholding and your wages are expected to usually be more than \$200 a week. See *Exemption From Withholding*, later.

The IRS may ask you for information showing how you figured either the number of allowances you claimed or your eligibility for exemption from withholding. If you choose, you can give this information to your employer to send to the IRS along with your Form W-4.

If the IRS determines that you cannot take all the allowances you claimed on your Form W-4, or that you are not exempt as claimed, it will inform both you and your employer and will specify the maximum number of allowances you can claim. The IRS also may ask you to fill out a new Form W-4. However, your employer cannot figure your withholding on the basis of more allowances than the maximum number determined by the IRS.

If you believe you are exempt or can claim more withholding allowances than determined by the IRS, you can complete a new Form W-4, stating on the form, or in a written statement, any circumstances that have changed or any other reasons for your claim. You can send it directly to the IRS or give it to your employer to send to the IRS. Your employer must continue to figure your withholding on the basis of the number of allowances previously determined by the IRS until the IRS advises your employer to withhold on the basis of the new Form W-4.

There is a penalty for supplying false information on Form W-4. See *Penalties*, later.

## Exemption From Withholding

If you claim exemption from withholding, your employer will not withhold federal income tax from your wages. The exemption applies only to income tax, not to social security or Medicare tax.

# Form W-4 (1997)

## Want More Money in Your Paycheck?

If you expect to be able to take the earned income credit for 1997 and a child lives with you, you may be able to have part of the credit added to your take-home pay. For details, get Form W-5 from your employer.

**Purpose.** Complete Form W-4 so that your employer can withhold the correct amount of Federal income tax from your pay. Form W-4 may be completed electronically, if your employer has an electronic system. Because your tax situation may change, you may want to refigure your withholding each year.

**Exemption From Withholding.** Read line 7 of the certificate below to see if you can claim exempt status. If exempt, only complete lines 1, 2, 3, 4, 7, and sign the form to validate it. No Federal income tax will be withheld from your pay. Your exemption expires February 17, 1998.

**Note:** You cannot claim exemption from withholding if (1) your income exceeds \$650 and includes unearned income (e.g., interest and dividends) and (2) another person can claim you as a dependent on their tax return.

**Basic Instructions.** If you are not exempt, complete the Personal Allowances Worksheet. Additional worksheets are on page 2 so you can adjust your withholding allowances based on itemized deductions, adjustments to income, or two-earner/two-job situations. Complete all worksheets that apply to your situation. The worksheets will help you figure the number of withholding allowances you are entitled to claim. However, you may claim fewer allowances than this.

**Head of Household.** Generally, you may claim head of household filing status on your tax return only if you are unmarried and pay more than 50% of the costs of keeping up a home for yourself and your dependent(s) or other qualifying individuals.

**Nonwage Income.** If you have a large amount of nonwage income, such as interest or dividends, you should consider making

estimated tax payments using Form 1040-ES. Otherwise, you may find that you owe additional tax at the end of the year.

**Two Earners/Two Jobs.** If you have a working spouse or more than one job, figure the total number of allowances you are entitled to claim on all jobs using worksheets from only one W-4. This total should be divided among all jobs. Your withholding will usually be most accurate when all allowances are claimed on the W-4 filed for the highest paying job and zero allowances are claimed for the others.

**Check Your Withholding.** After your W-4 takes effect, use Pub. 919, *Is My Withholding Correct for 1997?*, to see how the dollar amount you are having withheld compares to your estimated total annual tax. Get Pub. 919 especially if you used the Two-Earner/Two-Job Worksheet and your earnings exceed \$150,000 (Single) or \$200,000 (Married). To order Pub. 919, call 1-800-829-3676. Check your telephone directory for the IRS assistance number for further help.

**Sign This Form.** Form W-4 is not considered valid unless you sign it.

### Personal Allowances Worksheet

*Example 1.4*

- A Enter "1" for yourself if no one else can claim you as a dependent . . . . . A 1
- B Enter "1" if:   
 • You are single and have only one job; or   
 • You are married, have only one job, and your spouse does not work; or   
 • Your wages from a second job or your spouse's wages (or the total of both) are \$1,000 or less. . . . . B
- C Enter "1" for your spouse. But, you may choose to enter -0- if you are married and have either a working spouse or more than one job (this may help you avoid having too little tax withheld) . . . . . C 1
- D Enter number of dependents (other than your spouse or yourself) you will claim on your tax return . . . . . D 2
- E Enter "1" if you will file as head of household on your tax return (see conditions under Head of Household above) . . . . . E
- F Enter "1" if you have at least \$1,500 of child or dependent care expenses for which you plan to claim a credit . . . . . F 1
- G Add lines A through F and enter total here. Note: This amount may be different from the number of exemptions you claim on your return . . . . . G 5

For accuracy, complete all worksheets that apply.

- If you plan to itemize or claim adjustments to income and want to reduce your withholding, see the Deductions and Adjustments Worksheet on page 2.
- If you are single and have more than one job and your combined earnings from all jobs exceed \$32,000 OR if you are married and have a working spouse or more than one job, and the combined earnings from all jobs exceed \$55,000, see the Two-Earner/Two-Job Worksheet on page 2 if you want to avoid having too little tax withheld.
- If neither of the above situations applies, stop here and enter the number from line G on line 5 of Form W-4 below.

----- Cut here and give the certificate to your employer. Keep the top portion for your records. -----

Form <b>W-4</b> Department of the Treasury Internal Revenue Service		<b>Employee's Withholding Allowance Certificate</b>		OMB No. 1545-0010 <b>1997</b>
1 Type or print your first name and middle initial <b>John M.</b>		Last name <b>Green</b>		2 Your social security number <b>444 00 4444</b>
Home address (number and street or rural route) <b>915 Main St.</b>		3 <input type="checkbox"/> Single <input checked="" type="checkbox"/> Married <input type="checkbox"/> Married, but withhold at higher Single rate. <small>Note: If married, but legally separated, or spouse is a resident alien, check the Single box.</small>		
City or town, state, and ZIP code <b>Anytown, GA 00000</b>		4 If your last name differs from that on your social security card, check here and call 1-800-772-1213 for a new card . . . . . <input type="checkbox"/>		
5 Total number of allowances you are claiming (from line G above or from the worksheets on page 2 if they apply) . . . . .		6 Additional amount, if any, you want withheld from each paycheck . . . . .		5 <u>4</u> 6 <u>\$</u>
7 I claim exemption from withholding for 1997, and I certify that I meet BOTH of the following conditions for exemption: • Last year I had a right to a refund of ALL Federal income tax withheld because I had NO tax liability; AND • This year I expect a refund of ALL Federal income tax withheld because I expect to have NO tax liability. If you meet both conditions, enter "EXEMPT" here . . . . .		7 <u>    </u>		
Under penalties of perjury, I certify that I am entitled to the number of withholding allowances claimed on this certificate or entitled to claim exempt status.				
Employee's signature ▶ <b>John M. Green</b>		Date ▶ <b>January 4, 1997</b>		
8 Employer's name and address (Employer: Complete 8 and 10 only if sending to the IRS)		9 Office code (optional)	10 Employer identification number	

Cat. No. 10220C

**Deductions and Adjustments Worksheet**

**Note:** Use this worksheet only if you plan to itemize deductions or claim adjustments to income on your 1997 tax return.

1	Enter an estimate of your 1997 itemized deductions. These include qualifying home mortgage interest, charitable contributions, state and local taxes (but not sales taxes), medical expenses in excess of 7.5% of your income, and miscellaneous deductions. (For 1997, you may have to reduce your itemized deductions if your income is over \$121,200 (\$60,600 if married filing separately). Get Pub. 919 for details.)	1	\$ 11,200
2	Enter: $\left\{ \begin{array}{l} \$8,900 \text{ if married filing jointly or qualifying widow(er)} \\ \$6,050 \text{ if head of household} \\ \$4,150 \text{ if single} \\ \$3,450 \text{ if married filing separately} \end{array} \right.$	2	\$ 6,900
3	Subtract line 2 from line 1. If line 2 is greater than line 1, enter -0-	3	\$ 4,300
4	Enter an estimate of your 1997 adjustments to income. These include alimony paid and deductible IRA contributions	4	\$ 3,000
5	Add lines 3 and 4 and enter the total	5	\$ 7,300
6	Enter an estimate of your 1997 nonwage income (such as dividends or interest)	6	\$ 600
7	Subtract line 6 from line 5. Enter the result, but not less than -0-	7	\$ 6,700
8	Divide the amount on line 7 by \$2,500 and enter the result here. Drop any fraction	8	2
9	Enter the number from Personal Allowances Worksheet, line G, on page 1	9	5
10	Add lines 8 and 9 and enter the total here. If you plan to use the Two-Earner/Two-Job Worksheet, also enter this total on line 1 below. Otherwise, stop here and enter this total on Form W-4, line 5, on page 1.	10	7

**Two-Earner/Two-Job Worksheet**

**Note:** Use this worksheet only if the instructions for line G on page 1 direct you here.

1	Enter the number from line G on page 1 (or from line 10 above if you used the Deductions and Adjustments Worksheet)	1	7
2	Find the number in Table 1 below that applies to the LOWEST paying job and enter it here	2	3
3	If line 1 is GREATER THAN OR EQUAL TO line 2, subtract line 2 from line 1. Enter the result here (if zero, enter -0-) and on Form W-4, line 5, on page 1. DO NOT use the rest of this worksheet	3	4

**Note:** If line 1 is LESS THAN line 2, enter -0- on Form W-4, line 5, on page 1. Complete lines 4-9 to calculate the additional withholding amount necessary to avoid a year end tax bill.

4	Enter the number from line 2 of this worksheet	4	
5	Enter the number from line 1 of this worksheet	5	
6	Subtract line 5 from line 4	6	
7	Find the amount in Table 2 below that applies to the HIGHEST paying job and enter it here	7	\$
8	Multiply line 7 by line 6 and enter the result here. This is the additional annual withholding amount needed	8	\$
9	Divide line 8 by the number of pay periods remaining in 1997. (For example, divide by 26 if you are paid every other week and you complete this form in December 1996.) Enter the result here and on Form W-4, line 6, page 1. This is the additional amount to be withheld from each paycheck	9	\$

**Table 1: Two-Earner/Two-Job Worksheet**

Married Filing Jointly				All Others			
If wages from LOWEST paying job are—	Enter on line 2 above	If wages from LOWEST paying job are—	Enter on line 2 above	If wages from LOWEST paying job are—	Enter on line 2 above	If wages from LOWEST paying job are—	Enter on line 2 above
0 - \$4,000	0	35,001 - 40,000	8	0 - \$5,000	0	75,001 - 90,000	8
4,001 - 7,000	1	40,001 - 50,000	9	5,001 - 11,000	1	90,001 - 110,000	9
7,001 - 12,000	2	50,001 - 60,000	10	11,001 - 15,000	2	110,001 and over	10
12,001 - 17,000	3	60,001 - 70,000	11	15,001 - 20,000	3		
17,001 - 22,000	4	70,001 - 80,000	12	20,001 - 24,000	4		
22,001 - 28,000	5	80,001 - 100,000	13	24,001 - 45,000	5		
28,001 - 32,000	6	100,001 - 110,000	14	45,001 - 60,000	6		
32,001 - 35,000	7	110,001 and over	15	60,001 - 75,000	7		

**Table 2: Two-Earner/Two-Job Worksheet**

Married Filing Jointly		All Others	
If wages from HIGHEST paying job are—	Enter on line 7 above	If wages from HIGHEST paying job are—	Enter on line 7 above
0 - \$50,000	\$400	0 - \$30,000	\$400
50,001 - 100,000	740	30,001 - 60,000	740
100,001 - 130,000	820	60,001 - 120,000	820
130,001 - 240,000	950	120,001 - 250,000	950
240,001 and over	1,050	250,001 and over	1,050

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You can claim exemption from withholding for 1997 only if **both** the following situations apply.

- 1) For 1996 you had a right to a refund of all federal income tax withheld because you had no tax liability.
- 2) For 1997 you expect a refund of all federal income tax withheld because you expect to have no tax liability.

Use *Figure A* in this chapter to help you decide whether you can claim exemption. Do not use *Figure A* if you are 65 or older or blind or if you will itemize deductions or claim dependents or tax credits on your 1997 return. These situations are discussed later.

**Student.** If you are a student, you are not automatically exempt. See Publication 4, *Student's Guide to Federal Income Tax*, to see if you must file a return. If you work only part time or during the summer, you may qualify for exemption from withholding.

**Example 1.4.** You are a high school student and expect to earn \$2,500 from a summer job. You do not expect to have any other income during 1997, and your parents will be able to claim you as a dependent on their tax return. You worked last summer and had \$375 federal income tax withheld from your pay. The entire \$375 was refunded when you filed your 1996 return. Using *Figure A*, you find that you **can** claim exemption from withholding.

**Example 1.5.** The facts are the same as in Example 1.4, except that you have a savings account and expect to have \$20 interest income in 1997. Using *Figure A*, you find that you **cannot** claim exemption from withholding because your unearned income will be \$1 or more and your total income will be more than \$650.



**Age 65 or older or blind.** If you are 65 or older or blind, use one of the following worksheets to help you decide whether you can claim exemption from withholding. Do not use either worksheet if you will itemize deductions or claim dependents or tax credits on your 1997 return — instead, see the discussion that follows the worksheets.

**Worksheet 1.3**  
**Exemption From Withholding Worksheet**  
**for 65 or Older or Blind**

Use this worksheet only if, for **1996**, you had a right to a refund of **all** federal income tax withheld because you had **no** tax liability.

**Caution.** This worksheet does not apply if you can be claimed as a dependent. See Worksheet 1.4 instead.

1. Check the boxes below that apply to you.

65 or older                      Blind  
                                     

2. Check the boxes below that apply to your spouse if you will claim your spouse's exemption on your 1997 return.

65 or older                      Blind  
                                     

3. Add the number of boxes you checked in 1 and 2 above. Enter the result .....

You **can** claim exemption from withholding if:

Your filing status is:                      and the number on line 3 above is:                      and your 1997 total income will be no more than:

<b>Single</b>	1	\$ 7,800
	2	8,800
<b>Head of household</b>	1	\$ 9,700
	2	10,700
<b>Married filing separately for both 1996 and 1997</b>	1	\$ 6,900
	2	7,700
	3	8,500
	4	9,300
<b>Other married status</b>	1	\$ 13,000*
	2	13,800*
	3	14,600*
	4	15,400*

\*Include both spouses' income whether you will file separately or jointly.

<b>Qualifying widow(er)</b>	1	\$ 10,350
	2	11,150

You **cannot** claim exemption from withholding if your total income will be **more than** the amount shown for your filing status.

**Worksheet 1.4**  
**Exemption From Withholding Worksheet**  
**for Dependents Who Are 65 or Older or Blind**

Use this worksheet only if, for **1996**, you had a right to a refund of **all** federal income tax withheld because you had **no** tax liability.

1. Enter your expected earned income ... \_\_\_\_\_
2. Minimum amount ..... \$ 650
3. Compare lines 1 and 2. Enter the **larger** amount .....
4. Enter the appropriate amount from the following table .....

<b>Filing Status</b>	<b>Amount</b>
Single	\$4,150
Married filing separately	3,450

5. Compare lines 3 and 4. Enter the **smaller** amount .....

6. Enter the appropriate amount from the following table .....

<b>Filing Status</b>	<b>Amount</b>
Single	
Either 65 or older or blind	\$1,000
Both 65 or older and blind	2,000
Married filing separately	
Either 65 or older or blind	\$ 800
Both 65 or older and blind	1,600

7. Add lines 5 and 6. Enter the result .....
8. Enter your total expected income .....

You **can** claim exemption from withholding if line 7 is equal to or more than line 8. If line 8 is more than line 7, you **cannot** claim exemption from withholding.

**Itemizing deductions or claiming dependents or tax credits.** If you had no tax liability for 1996 and you will itemize your deductions or claim dependents or tax credits on your 1997 return, use the 1997 Estimated Tax Worksheet in Form 1040-ES, *Estimated Tax for Individuals* (also see Chapter 2), to figure your 1997 expected tax liability. You can claim exemption from withholding only if your total expected tax liability (line 13c of the worksheet) is zero.

**Claiming exemption.** To claim exemption, you must give your employer a Form W-4. Write "EXEMPT" on line 7.

Your employer must send the IRS a copy of your Form W-4 if you claim exemption from withholding and your pay is expected to usually be more than \$200 a week. If it turns out that you do not qualify for exemption, the IRS will send both you and your employer a written notice.

If you claim exemption, but later your situation changes so that you will have to pay income tax after all, you must file a new Form W-4 within 10 days after the change. If you claim exemption in 1997, but you expect to owe income tax for 1998, you must file a new Form W-4 by December 1, 1997.

**An exemption is good for only one year.** You must give your employer a new Form W-4 by February 15 each year to continue your exemption.

## Supplemental Wages

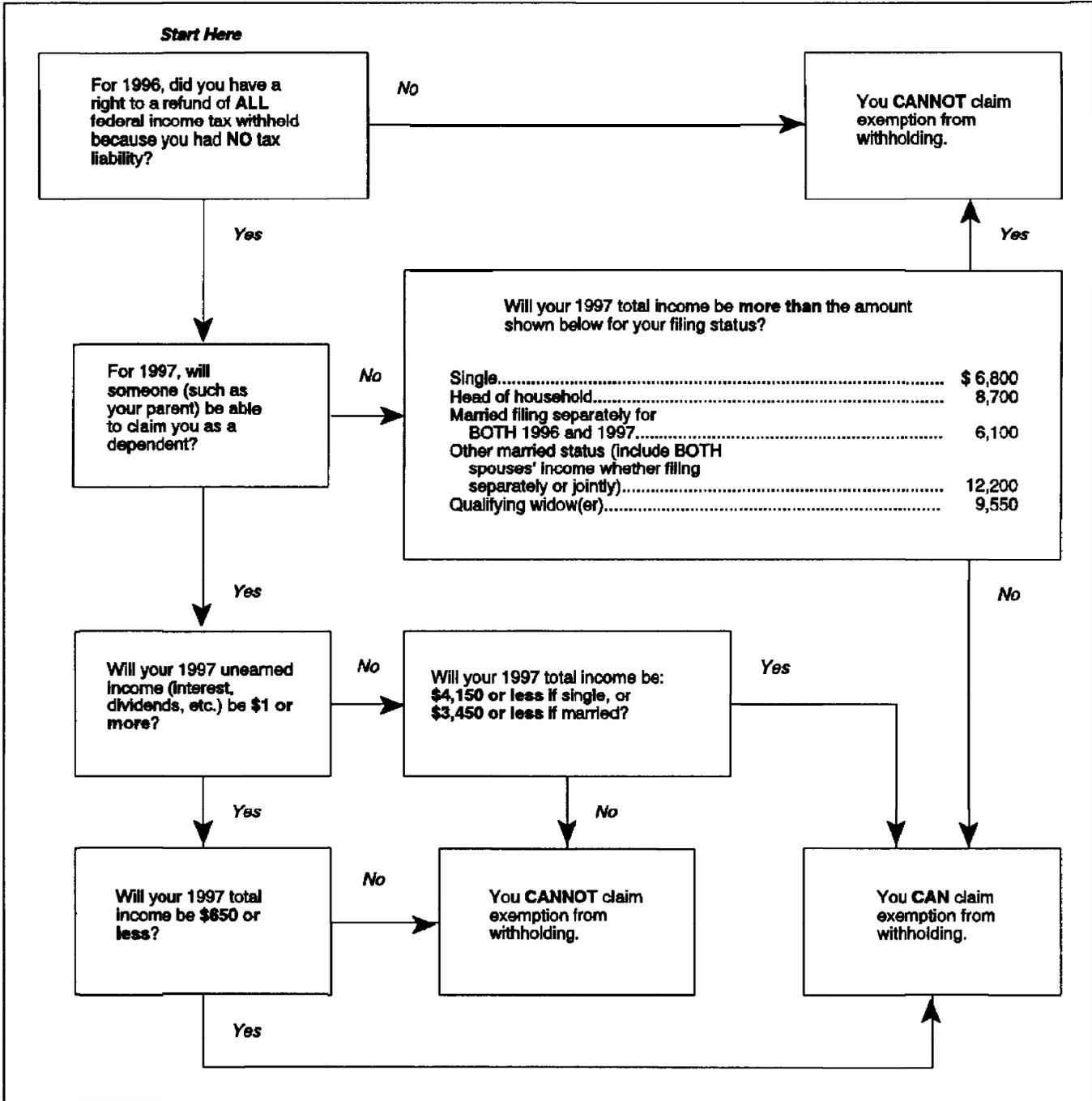
Supplemental wages include bonuses, commissions, overtime pay, and certain sick pay. Your employer or other payer of supplemental wages may withhold income tax from these wages at a flat rate of 28%. The payer can also figure withholding using the same method used for your regular wages.

Also see *Sick Pay*, later.

**Expense allowances.** Reimbursements or other expense allowances paid by your employer under a nonaccountable plan are treated as supplemental wages. A nonaccountable plan is a reimbursement arrangement that does not require you to account for, or prove, your business expenses to your employer or does not require you to return your

## Figure A. Exemption From Withholding on Form W-4

Note: Do not use this chart if you are 65 or older or blind, or if you will itemize your deductions or claim dependents or tax credits. Instead, see the discussions in this chapter under *Exemption From Withholding*.



employer's payments that are more than your proven expenses.

Reimbursements or other expense allowances paid under an accountable plan that are more than your proven expenses are treated as paid under a nonaccountable plan. However, this does not apply if you return the excess payments within a reasonable period of time.

For more information about accountable and nonaccountable expense allowance plans, see Chapter 6 of Publication 463, *Travel, Entertainment, Gift, and Car Expenses*.

## Penalties

You may have to pay a penalty of \$500 if:

- 1) You make statements or claim withholding allowances on your Form W-4 that reduce the amount of tax withheld, and
- 2) You have no reasonable basis for those statements or allowances at the time you prepare your Form W-4.

There is also a criminal penalty for willfully supplying false or fraudulent information on your Form W-4 or for willfully failing to supply information that would increase the amount withheld. The penalty upon conviction can be either a fine of up to \$1,000 or imprisonment for up to one year, or both.

These penalties will apply if you deliberately and knowingly falsify your Form W-4 in an attempt to reduce or eliminate the proper withholding of taxes. A simple error — an honest mistake — will not result in one of these penalties. For example, a person who has tried to figure the number of withholding allowances correctly, but claims seven when the proper number is six, will not be charged a Form W-4 penalty. However, see Chapter 4 for information on the underpayment penalty.

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## Tips

The tips you receive while working on your job are considered part of your pay. You must include your tips on your tax return on the same line as your regular pay. However, tax is not withheld directly from tip income, as it is from your regular pay. Nevertheless, your employer will take into account the tips you report when figuring how much to withhold from your regular pay.

**Reporting tips to your employer.** If you receive tips of \$20 or more in a month while working for any one employer, you must report to your employer the total amount of tips you receive on the job during the month. The report is due by the 10th day of the following month.

If you have more than one job, make a separate report to each employer. Report only the tips you received while working for that employer, and only if they total \$20 or more for the month.

**How employer figures amount to withhold.** The tips you report to your employer are counted as part of your income for the month you report them. Your employer can figure your withholding in either of two ways:

- 1) By withholding at the regular rate on the sum of your pay plus your reported tips, or
- 2) By withholding at the regular rate on your pay plus an amount equal to 28% of your reported tips.

**Not enough pay to cover taxes.** If your regular pay is too low for your employer to withhold all the tax (including social security tax, Medicare tax, or railroad retirement tax) due on your pay plus your tips, you may give your employer money to cover the shortage.

If you do not give your employer money to cover the shortage, your employer will first withhold as much social security tax, Medicare tax, or railroad retirement tax as possible, up to the proper amount, and then withhold income tax up to the full amount of your pay. If not enough tax is withheld, you may have to make estimated tax payments. When you file

your return, you also may have to pay any social security tax, Medicare tax, or railroad retirement tax your employer could not withhold.

**Tips not reported to your employer.** On your tax return, you must report **all** the tips you receive during the year, even tips you do not report to your employer. Make sure you are having enough tax withheld, or are paying estimated tax, to cover all your tip income.

**Allocated tips.** If you work in a large establishment that serves food or beverages to customers, your employer may have to report an allocated amount of tips on your Form W-2.

Your employer should not withhold income tax, social security tax, Medicare tax, or railroad retirement tax on the allocated amount. Withholding is based only on your pay plus your **reported tips**. Your employer should refund to you any incorrectly withheld tax.

**More information.** For more information on the withholding rules for tip income and on tip allocation, get Publication 531, *Reporting Tip Income*.

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## Taxable Fringe Benefits

The value of certain noncash fringe benefits you receive from your employer is considered part of your pay. Your employer generally must withhold income tax on these benefits from your regular pay for the period the benefits are paid or considered paid.

For information on taxable fringe benefits, see *Fringe Benefits under Employee Compensation* in Publication 525, *Taxable and Nontaxable Income*.

Your employer can choose not to withhold income tax on the value of your personal use of a car, truck, or other highway motor vehicle provided by your employer. Your employer must notify you if this choice is made.

**When benefits are considered paid.** Your employer can choose to treat a fringe benefit as paid by the pay period, by the quarter, or on some other basis as long as the benefit is considered paid at least once a year. Your employer can treat the benefit as being paid on one or more dates during the year, even if you get the entire benefit at one time.

**Special rule.** Your employer can choose to treat a benefit provided during November or December as paid in the next year. Your employer must notify you if this rule is used.

**Example 1.6.** Your employer considers the value of benefits paid from November 1, 1995, through October 31, 1996, as paid to you in 1996. To determine the total value of benefits paid to you in 1997, your employer will add the value of any benefits paid in November and December of 1996 to the value of any benefits paid in January through October of 1997.

**Exceptions.** Your employer cannot choose when to withhold tax on certain benefits. These benefits are transfers of either real property or personal property of a kind normally held for investment (such as stock).

Your employer must withhold tax on these benefits at the time of the transfer.

**How withholding is figured.** Your employer can either add the value of a fringe benefit to your regular pay and figure income tax withholding on the total or withhold 28% of the benefit's value.

If the benefit's actual value cannot be determined when it is paid or treated as paid, your employer can use a reasonable estimate. Your employer must determine the actual value of the benefit by January 31 of the next year. If the actual value is more than the estimate, your employer must pay the IRS any additional withholding tax required. Your employer has until April 1 of that next year to recover from you the additional tax paid to the IRS for you.

**How your employer reports your benefits.** Your employer must report on Form W-2, *Wage and Tax Statement*, the total of the taxable fringe benefits paid or treated as paid to you during the year and the tax withheld for the benefits. These amounts can be shown either on the Form W-2 for your regular pay or on a separate Form W-2. If your employer provided you with a car, truck, or other motor vehicle and chose to treat all of your use of it as personal, its value must be either separately shown on Form W-2 or reported to you on a separate statement.

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## Sick Pay

“Sick pay” is a payment to you to replace your regular wages while you are temporarily absent from work due to sickness or personal injury. To qualify as “sick pay,” it must be paid under a plan to which your employer is a party.

If you receive sick pay from your employer or an agent of your employer, income tax must be withheld just as it is from your regular pay.

However, if you receive sick pay from a third party who is not acting as an agent of your employer, income tax will be withheld only if you choose to have it withheld. See *Form W-4S*, later.

If you receive payments under a plan in which your employer does not participate (such as an accident or health plan where you paid all the premiums), the payments are not sick pay and usually are not taxable.

**Union agreements.** If you receive sick pay under a collective bargaining agreement between your union and your employer, the agreement may determine the amount of income tax withholding. See your union representative or your employer for more information.

**Form W-4S.** If you choose to have income tax withheld from sick pay paid by a third party, such as an insurance company, you must fill out Form W-4S, *Request for Federal Income Tax Withholding From Sick Pay*. Its instructions contain a worksheet you can use to figure the amount you want withheld. They also explain restrictions that may apply.

Give the completed form to the payer of your sick pay. The payer must withhold according to your directions on the form.

If you do not request withholding on Form W-4S, or if you do not have enough tax withheld, you may have to make estimated tax payments. If you do not pay enough estimated tax or have enough income tax withheld, you may have to pay a penalty. See Chapter 2 and Chapter 4.

Form W-4S remains in effect until you change or cancel it, or stop receiving payments. You can change your withholding by giving a new Form W-4S or a written notice to the payer of your sick pay.

## Pensions and Annuities

Income tax usually will be withheld from your pension or annuity distributions, unless you choose not to have it withheld. This rule applies to distributions from:

- 1) An individual retirement arrangement (IRA),
- 2) A life insurance company under an endowment, annuity, or life insurance contract,
- 3) A pension, annuity, or profit-sharing plan,
- 4) A stock bonus plan, and
- 5) Any other plan that defers the time you receive compensation.

The amount withheld depends on whether you receive payments spread out over more than one year (periodic payments), within one year (nonperiodic payments), or as an eligible rollover distribution (EDR).

You cannot choose not to have income tax withheld from an EDR. EDRs are discussed later.

**Nontaxable part.** A part of your pension or annuity may not be taxable. This is the part that is a return of your investment in your retirement plan — the amount you paid into the plan or its cost to you. Income tax will not be withheld from the part of your pension or annuity that is not taxable. The tax withheld will be figured on, and cannot be more than, the taxable part.

For information about figuring the part of your pension or annuity that is not taxable, see Publication 575, *Pension and Annuity Income (Including Simplified General Rule)*.

## Periodic Payments

Withholding from periodic payments of a pension or annuity is figured in the same way as withholding from salaries and wages. To tell the payer of your pension or annuity how much you want withheld, fill out **Form W-4P**, *Withholding Certificate for Pension or Annuity Payments*, or a similar form provided by the payer. Follow the rules discussed under *Salaries and Wages*, earlier, to fill out your Form W-4P.

The withholding rules for pensions and annuities differ from those for salaries and wages in the following ways.

- 1) **If you do not fill out a withholding certificate**, tax will be withheld as if you were married and claiming three withholding allowances. This means that tax will be withheld only if your pension or annuity is more than \$1,200 a month (or \$14,400 a year).
- 2) **Your certificate will not be sent to the IRS** regardless of the number of allowances you claim on it.
- 3) **You can choose not to have tax withheld**, regardless of how much tax you owed last year or expect to owe this year. You do not have to qualify for exemption. See *Choosing Not To Have Income Tax Withheld*, later.
- 4) **If you do not give the payer your social security number** (in the required manner) or the IRS notifies the payer, before any payment or distribution is made, that you gave it an incorrect social security number, tax will be withheld as if you were single and were claiming no withholding allowances.

**Military retirement pay.** This generally is treated in the same manner as wages and not as a pension or annuity for income tax withholding purposes. Military retirees should use Form W-4, not Form W-4P.

**Effective date of withholding certificate.** If you give your withholding certificate (Form W-4P or a similar form) to the payer by the time your payments start, it will be put into effect by the first payment made more than 30 days after you submit the certificate.

If you give the payer your certificate after your payments start, it will be put into effect with the first payment made on or after January 1, May 1, July 1, or October 1, whichever is at least 30 days after you submit it. However, the payer can elect to put it into effect earlier.

## Nonperiodic Payments

Tax will be withheld at a 10% rate on any nonperiodic payments you receive.

If you receive a total distribution because of the death of the person covered by the plan, a \$5,000 death benefit exclusion may also apply. (This exclusion has been repealed in cases where the person covered by the plan died after August 20, 1996.) If this exclusion applies, tax will not be withheld on this part of the distribution. For more information, see *Death benefit exclusion* under *Simplified General Rule* in Publication 575.

Because withholding on nonperiodic payments does not depend on withholding allowances or whether you are married or single, you cannot use Form W-4P to tell the payer how much to withhold. But you can use Form W-4P to specify that an additional amount be withheld. You can also use Form W-4P to choose not to have tax withheld or to revoke a choice not to have tax withheld.



The 10% rate of withholding on nonperiodic payments is less than the lowest tax rate (15%). You may need to use Form W-4P to ask for additional withholding. If you do not have enough tax withheld, you may need to make estimated tax payments, as explained in Chapter 2.

## Eligible Rollover Distributions

Distributions you receive that are eligible to be rolled over tax free into qualified retirement or annuity plans are subject to a 20% withholding tax.

This type of distribution is called an **eligible rollover distribution (ERD)**. This is any distribution from a qualified pension plan or tax-sheltered annuity other than:

- 1) A minimum required distribution, or
- 2) One of a series of substantially equal periodic pension or annuity payments made over:
  - a) Your life (or your life expectancy) or the joint lives of you and your beneficiary (or your life expectancies), or
  - b) A specified period of 10 or more years.

The withholding rules for non-ERD distributions are discussed earlier under *Periodic Payments* and *Nonperiodic Payments*.

A distribution is subject to withholding if it is not substantially equal to the periodic payments.

For example, upon retirement you receive 30% of your accrued pension benefits in the form of a single-sum distribution with the balance payable in annuity form. The 30% distribution is an ERD subject to 20% withholding. The annuity payments are periodic payments subject to withholding only if you choose to have withholding taken out.

The payer of a distribution must withhold at a 20% rate on any part of an ERD that is not rolled over directly to another qualified plan. You cannot elect not to have withholding on these distributions.

If tax is withheld on the ERD, it will be withheld only on the taxable part. You must either:

- 1) Contribute to the new plan (within 60 days from the date of the distribution) an amount equal to the taxable part of the total ERD, including the amount withheld, or
- 2) Include in your income for the year of the distribution any amount withheld for which you did not make a matching contribution to the new plan.

The matching contribution to cover the withheld amount must be in addition to the rollover of all the taxable part that you actually received.

Therefore, if the amount you actually received is less than the taxable part of the ERD and you do not:

- 1) Roll over the entire amount received, and
- 2) Also contribute to the new plan an amount sufficient to bring the total of the

rollover plus the additional amount contributed up to an amount equal to that taxable part,

you must include any difference in your income.

If the amount you actually received is more than the taxable part of the total ERD, you cannot roll over more than the taxable part. If you roll over an amount equal to the taxable part, you do not have to include any of the amount withheld in your income. If you roll over less than the taxable part, you must include in your income the difference between the amount you roll over and the taxable part.

**Exception to withholding rule.** The only way to avoid withholding on an ERD is to have it directly rolled over from the employer's plan to a qualified plan or IRA. This direct rollover is made only at your direction. You must first make sure that the receiving trustee agrees to accept a direct rollover. The transferor trustee must allow you to make such a rollover and provide to you, within a reasonable period of time, written instructions on how to do so. You must also follow spousal consent and other participant and beneficiary protection rules.

**More information.** For more information on taxation of annuities and distributions from qualified retirement plans, see Publication 575. For information on IRAs, see Publication 590, *Individual Retirement Arrangements (IRAs)*.

## Choosing Not To Have Income Tax Withheld

You can choose not to have income tax withheld from your pension or annuity, whether the payments are periodic or nonperiodic. This rule does not apply to eligible rollover distributions. The payer will tell you how to make this choice. If you use Form W-4P, check the box on line 1 to make this choice. This choice will remain in effect until you decide you want withholding.

The payer will ignore your request not to have income tax withheld if:

- 1) You do not give the payer your social security number (in the required manner), or
- 2) The IRS notifies the payer, before any payment or distribution is made, that you gave it an incorrect social security number.

If you choose not to have any income tax withheld from your pension or annuity, or if you do not have enough withheld, you may have to make estimated tax payments. See Chapter 2.

If you do not pay enough tax either through estimated tax or withholding, you may have to pay a penalty. See Chapter 4 for information about this penalty.

**Outside United States.** If you are a U.S. citizen or resident alien and you do not want to have tax withheld from pension or annuity benefits, you must give the payer of the benefits a home address in the United States or in a

U.S. possession. Otherwise, the payer must withhold tax. For example, the payer would have to withhold tax if you provide a U.S. address for a nominee, trustee, or agent to whom the benefits are to be delivered, but do not provide your own home address in the United States or in a U.S. possession.

**Revoking a choice not to have tax withheld.** If you want to revoke your choice not to have tax withheld, the payer of your pension or annuity will tell you how. If the payer gives you Form W-4P, write "Revoked" by the checkbox on line 1 of the form.

If you get periodic payments and do not complete the rest of the form, the payer will withhold tax as if you were married and claiming three allowances. If you want tax withheld at a different rate, you must complete the rest of the form.

**Notice required of payer.** The payer of your pension or annuity must send you a notice telling you about your right to choose not to have tax withheld.

Generally, the payer will not send a notice to you if it is reasonable to believe that the entire amount you will be paid is not taxable.

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## Gambling Winnings

Income tax is withheld from certain kinds of gambling winnings. The amount withheld is 28% of the proceeds paid (the amount of your winnings minus the amount of your bet).

Gambling winnings of more than \$5,000 from the following sources are subject to income tax withholding:

- 1) Any sweepstakes, wagering pool, or lottery, and
- 2) Any other wager if the proceeds are at least 300 times the amount of the bet.

It does not matter whether your winnings are paid in cash, in property, or as an annuity. Winnings not in money are taken into account at their fair market value.

Gambling winnings from bingo, keno, and slot machines are not subject to income tax withholding. If you receive gambling winnings not subject to withholding, you may need to make estimated tax payments. (See Chapter 2.)

If you do not pay enough tax through withholding or estimated tax payments, you may be subject to a penalty. (See Chapter 4.)

**Form W-2G.** If a payer withholds income tax from your gambling winnings, you should receive a Form W-2G, *Certain Gambling Winnings*, showing the amount you won and the amount withheld.

**Reporting your winnings.** Report your winnings on line 21 of Form 1040. Report the tax withheld on line 52 of Form 1040. Gambling losses are deductible only to the extent they offset gambling winnings. You must use Schedule A (Form 1040) to deduct your losses and to deduct state tax withholding.

**Information to give payer.** If the payer asks, you must give the payer the following information:

- 1) Your name, address, and social security number,
- 2) Whether you made identical wagers (explained next), and
- 3) Whether someone else is entitled to any part of the winnings subject to withholding. If so, you must complete Form 5754, *Statement by Person(s) Receiving Gambling Winnings*, and return it to the payer. The payer will use it to prepare a Form W-2G for each of the winners.

**Identical wagers.** You may have to give the payer a statement of the amount of your winnings, if any, from identical wagers. If this statement is required, the payer will ask you for it. You provide this statement by signing Form W-2G or, if required, Form 5754.

Identical wagers include two bets placed in a pari-mutuel pool on one horse to win a particular race. However, the bets are not identical if one bet is "to win" and one bet is "to place." In addition, they are not identical if the bets were placed in different pari-mutuel pools (for example, one pool conducted by the race-track and a separate pool conducted by an off-track betting establishment in which the bets are not pooled with those placed at the track).

**Backup withholding.** If you have any kind of gambling winnings and do not give the payer your social security number, the payer may have to withhold income tax at the rate of 31%. This rule applies to keno winnings of more than \$1,500, bingo and slot machine winnings of more than \$1,200, and certain other gambling winnings of more than \$600.

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## Unemployment Compensation

Beginning in 1997, you can choose to have income tax withheld from any unemployment compensation you get. To make this choice, you will have to fill out **Form W-4V**, *Voluntary Withholding Request*, (or a similar form provided by the payer) and give it to the payer. The amount withheld will be 15% of each payment.

Unemployment compensation is taxable. So, if you do not have income tax withheld, you may have to make estimated tax payments. See Chapter 2.

If you do not pay enough tax either through withholding or estimated tax, you may have to pay a penalty. See Chapter 4.

**Form 1099-G.** If income tax is withheld from your unemployment compensation, you will receive a Form 1099-G, *Certain Government Payments*. Box 1 will show the amount of unemployment compensation you got for the year. Box 4 will show the amount of tax withheld.

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# Social Security and Other Federal Payments

Beginning in 1997, you can choose to have income tax withheld from certain federal payments you receive. These payments are:

- 1) Social security benefits,
- 2) Tier 1 railroad retirement benefits,
- 3) Commodity credit loans, and
- 4) Payments under the Agricultural Act of 1949, or title II of the Disaster Assistance Act of 1988, as amended, that are treated as insurance proceeds and that you received because:
  - a) Your crops were destroyed or damaged by drought, flood, or any other natural disaster, or
  - b) You were unable to plant crops because of a natural disaster described in (a).

To make this choice, you will have to fill out **Form W-4V, Voluntary Withholding Request**, (or a similar form provided by the payer) and give it to the payer. You can choose to have 7%, 15%, 28%, or 31% of each payment withheld.

If you do not choose to have income tax withheld, you may have to make estimated tax payments. See Chapter 2.

If you do not pay enough tax either through withholding or estimated tax, you may have to pay a penalty. See Chapter 4.

**More information.** For more information about the tax treatment of social security and railroad retirement benefits, get Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*. Get Publication 225, *Farmer's Tax Guide*, for information about the tax treatment of commodity credit loans or crop disaster payments.

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## Backup Withholding

Banks or other businesses that pay you certain kinds of income must file an information return (Form 1099) with the IRS. The information return shows how much you were paid during the year. It also includes your name and taxpayer identification number (TIN). TINs are explained later in this discussion.

These payments generally are not subject to withholding. However, "backup" withholding is required in certain situations.

**Payments subject to backup withholding.** Backup withholding can apply to most kinds of payments that are reported on Form 1099. These include:

- **Interest payments** (Form 1099-INT),
- **Dividends** (Form 1099-DIV),
- **Patronage dividends**, but only if at least half the payment is in money (Form 1099-PATR),

- **Rents, profits, or other gains** (Form 1099-MISC),
- **Commissions, fees**, or other payments for work you do as an independent contractor (Form 1099-MISC),
- **Payments by brokers** (Form 1099-B),
- **Payments by fishing boat operators**, but only the part that is in money and that represents a share of the proceeds of the catch (Form 1099-MISC), and
- **Royalty payments** (Form 1099-MISC).

Backup withholding may also apply to gambling winnings. See *Backup withholding under Gambling Winnings*, earlier.

**Payments not subject to backup withholding.** Backup withholding does not apply to payments reported on Form 1099-MISC (other than payments by fishing boat operators and royalty payments) **unless** at least one of the following situations applies.

- 1) The amount you receive from any one payer is \$600 or more.
- 2) The payer had to give you a Form 1099 last year.
- 3) The payer made payments to you last year that were subject to backup withholding.

Form 1099 and backup withholding are generally not required for a payment of less than \$10.

**Withholding rules.** When you open a new account, make an investment, or begin to receive payments reported on Form 1099, the bank or other business will give you **Form W-9, Request for Taxpayer Identification Number and Certification**, or a similar form. You must show your TIN on the form and, if your account or investment will earn interest or dividends, you also must certify (under penalties of perjury) that your TIN is correct and that you are not subject to backup withholding.

Payments made to you are subject to backup withholding at a flat 31% rate in the following situations.

- 1) You do not give the payer your TIN in the required manner.
- 2) The IRS notifies the payer that the TIN you gave is incorrect.
- 3) You are required, but fail, to certify that you are not subject to backup withholding.
- 4) The IRS notifies the payer to start withholding on interest or dividends because you have underreported interest or dividends on your income tax return. The IRS will do this only after it has mailed you four notices over at least a 120-day period.

**Taxpayer identification number (TIN).** Your TIN is one of the following:

- 1) Your social security number (SSN),

- 2) Your employer identification number, or
- 3) An IRS individual taxpayer identification number (ITIN). Aliens who do not have an SSN and are not eligible to get one should get an ITIN. **Form W-7, Application for IRS Individual Taxpayer Identification Number**, is used to apply for an ITIN.

An ITIN is for tax use only. It does not entitle you to social security benefits or change your employment or immigration status under U.S. law.

**How to prevent or stop backup withholding.** If you have been notified by a payer that the TIN you gave is incorrect, you can usually prevent backup withholding from starting or stop backup withholding once it has begun by giving the payer your correct name and TIN. You must certify that the TIN you give is correct.

However, the payer will provide additional instructions if the TIN you gave needs to be validated by the Social Security Administration or by the IRS. This may happen if both the following conditions exist.

- 1) The IRS notifies the payer twice within 3 calendar years that a TIN you gave for the same account is incorrect.
- 2) The incorrect TIN is still being used on the account when the payer receives the second notice.

**Underreported interest or dividends.** If you have been notified that you underreported interest or dividends, you must request a determination from the IRS to prevent backup withholding from starting or to stop backup withholding once it has begun. You must show that at least one of the following situations applies.

- 1) No underreporting occurred.
- 2) You have a bona fide dispute with the IRS about whether an underreporting occurred.
- 3) Backup withholding will cause or is causing an undue hardship and it is unlikely that you will underreport interest and dividends in the future.
- 4) You have corrected the underreporting by filing a return if you did not previously file one and by paying all taxes, penalties, and interest due for any underreported interest or dividend payments.

If the IRS determines that backup withholding should stop, it will provide you with a certification and will notify the payers who were sent notices earlier.

**Penalties.** There are civil and criminal penalties for giving false information to avoid backup withholding. The civil penalty is \$500. The criminal penalty, upon conviction, is a fine of up to \$1,000, or imprisonment of up to one year, or both.

# Estimated Tax for 1997

## Important Reminders

**Employment taxes on household employees.** If you must make estimated tax payments anyway, you have the option of including any expected employment (social security, Medicare, and federal unemployment) taxes for household employees when figuring your estimated tax for 1997.

When figuring your estimated tax for 1998, you **must** include these taxes.

**Exception to use of prior year's tax.** Certain taxpayers (other than farmers and fishermen) must use 110% of their 1996 tax to figure their 1997 estimated tax payments. See *Higher income taxpayers* under *Required Annual Payment*, later.

## Introduction

This chapter explains the use of **Form 1040-ES**, *Estimated Tax for Individuals*, to figure and pay estimated tax.

Estimated tax is the method used to pay tax on income that is not subject to withholding. This includes income from self-employment, interest, dividends, alimony, rent, gains from the sale of assets, prizes, and awards. You also may have to pay estimated tax if the amount of income tax being withheld from your salary, pension, or other income is not enough.

Estimated tax is used to pay both income tax and self-employment tax, as well as other taxes and amounts reported on your tax return. If you do not pay enough through withholding or by making estimated tax payments, you may be charged a penalty. If you do not pay enough by the due date of each payment period (see *When To Pay Estimated Tax*, later), you may be charged a penalty even if you are due a refund when you file your tax return. For information on when the penalty applies, see Chapter 4.

It would be helpful for you to keep a copy of your 1996 tax return and an estimate of your 1997 taxes nearby while reading this chapter.

## Topics

This chapter discusses:

- Who must make estimated tax payments
- How to figure estimated tax (including illustrated examples)
- When to pay estimated tax
- How to figure each payment
- How to pay estimated tax

## Useful Items

You may want to see:

### Publication

- 553** Highlights of 1996 Tax Changes

### Form (and Instructions)

- 1040-ES** Estimated Tax for Individuals

See Chapter 5 for information about how to get this publication and form.

## Who Must Make Estimated Tax Payments

If you had a tax liability for 1996, you may have to pay estimated tax for 1997.

**General rule.** You must make estimated tax payments for 1997 if you expect to owe at least \$500 in tax for 1997, after subtracting your withholding and credits, and you expect your withholding and credits to be less than the smaller of:

- 1) 90% of the tax to be shown on your 1997 tax return, or
- 2) 100% of the tax shown on your 1996 tax return. Your 1996 tax return must cover all 12 months.

**Exceptions.** There are exceptions to the general rule for farmers and fishermen and for certain higher income taxpayers.

**Farmers and fishermen.** If at least two-thirds of your gross income for 1996 or 1997 is from farming or fishing, substitute 66  $\frac{2}{3}$ % for 90% in (1) above.

For definitions of gross income from farming and gross income from fishing, see *Farmers and Fishermen* later under *When To Pay Estimated Tax*.

**Higher income taxpayers.** If less than two-thirds of your gross income for 1996 and 1997 is from farming or fishing and your adjusted gross income (AGI) for 1996 was more than \$150,000 (\$75,000 if your filing status for 1997 is married filing a separate return), substitute 110% for 100% in (2) above.

For 1996, AGI is the amount shown on Form 1040 – line 31; Form 1040A – line 16; and Form 1040EZ – line 4.

**Note:** If all your 1997 income will be subject to income tax withholding, you probably do not need to make estimated tax payments.

**Example 2.1.** To figure whether she should pay estimated tax for 1997, Jane, who files as head of household, uses the following information.

Expected AGI for 1997	\$61,125
AGI for 1996	\$58,950
Tax shown on 1996 return	\$11,000
Tax expected to be shown on 1997 return	\$10,000
Tax expected to be withheld in 1997	\$9,200

Jane uses *Figure B*. Jane's answer to the chart's first question is YES — she expects to owe at least \$500 for 1997 after subtracting her withholding from her expected tax (\$10,000 – \$9,200 = \$800). Her answer to the chart's second question is also YES — she expects her income tax withholding (\$9,200) to be at least 90% of the tax to be shown on her 1997 return (\$10,000 × 90% = \$9,000). Jane does not need to pay estimated tax.

**Example 2.2.** The facts are the same as in Example 2.1, except that Jane expects only \$8,500 tax to be withheld in 1997. Because that is less than \$9,000, her answer to the chart's second question is NO.

Jane's answer to the chart's third question is also NO — she does not expect her income tax withholding (\$8,500) to be at least 100% of the tax shown on her 1996 return (\$11,000). Jane must make estimated tax payments for 1997.

**Example 2.3.** The facts are the same as in Example 2.2, except that the tax shown on Jane's 1996 return was \$8,000. Because that is less than her expected withholding in 1997, her answer to the chart's third question is YES. Jane does not need to pay estimated tax for 1997.

**To whom the rules apply.** The estimated tax rules apply to:

- U.S. citizens and residents,
- Residents of Puerto Rico, the Virgin Islands, Guam, the Commonwealth of the Northern Mariana Islands, and American Samoa, and
- Nonresident aliens.

**Aliens.** Resident and nonresident aliens have to make estimated tax payments. Resident aliens should follow the rules in this publication, unless noted otherwise. Nonresident aliens should get **Form 1040-ES(NR)**, *U.S. Estimated Tax for Nonresident Alien Individuals*.

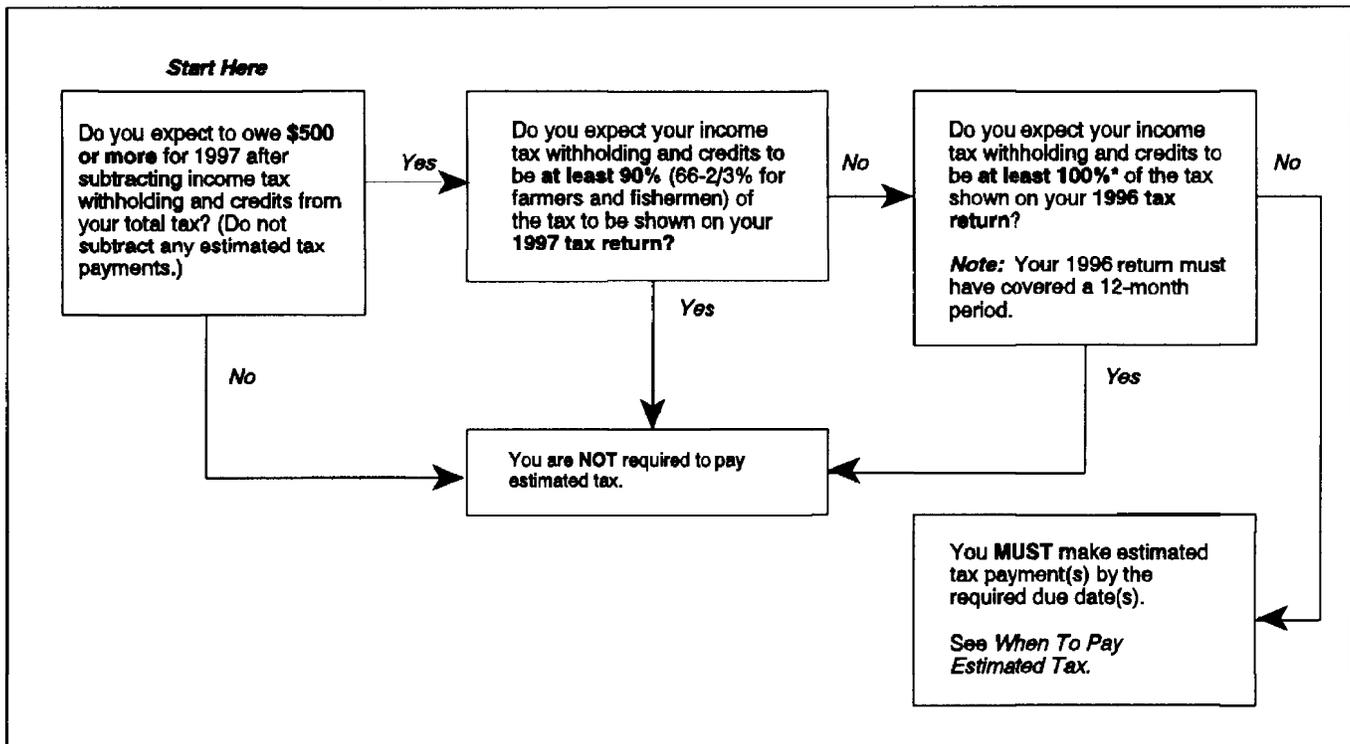
**Avoiding estimated tax.** If, in addition to income not subject to withholding, you also receive salaries and wages, you can avoid having to make estimated tax payments by asking your employer to take more tax out of your earnings. To do this, file a new Form W-4, *Employee's Withholding Allowance Certificate*, with your employer. See Chapter 1.

**No tax liability last year.** You do not have to pay estimated tax for 1997 if you meet all three of the following conditions.

- 1) You had no tax liability for your 1996 tax year,
- 2) You were a U.S. citizen or resident for the whole year, and
- 3) Your 1996 tax year covered a 12-month period.

You had no tax liability for 1996 if your total tax (defined later under *Required Annual Payment*) was zero or you did not have to file an income tax return.

**Figure B. Do You Have To Pay Estimated Tax?**



\* 110% if less than two-thirds of your gross income for 1996 and 1997 is from farming or fishing and your 1996 adjusted gross income was more than \$150,000 (\$75,000 if your filing status for 1997 is married filing a separate return)

**Married taxpayers.** To figure whether you must make estimated tax payments for 1997, apply the rules discussed here to your 1997 separate estimated income. If you can make joint estimated tax payments, you can apply these rules on a joint basis.

You and your spouse can make joint payments of estimated tax even if you are not living together.

You and your spouse cannot make joint estimated tax payments if you are separated under a decree of divorce or separate maintenance. Also, you cannot make joint estimated tax payments if either spouse is a nonresident alien or if you have different tax years.

Whether you and your spouse make joint estimated tax payments or separate payments will not affect your choice of filing a joint tax return or separate returns for 1997.

**1996 separate returns and 1997 joint return.** If you plan to file a joint return with your spouse for 1997, but you filed separate returns for 1996, your 1996 tax is the total of the tax shown on your separate returns. You filed a separate return for 1996 if you filed as single, head of household, or married filing separately.

**1996 joint return and 1997 separate returns.** If you plan to file a separate return for 1997, but you filed a joint return with your spouse for 1996, your 1996 tax is your share of the tax on the joint return. You file a separate return for 1997 if you file as single, head of household, or married filing separately. To figure your share, first figure the tax both you and your spouse would have paid had you filed separate returns for 1996 using the same filing

status as for 1997. Then multiply your joint tax liability by the following fraction:

$$\frac{\text{Your separate tax liability}}{\text{Both spouses' separate tax liabilities}}$$

**Example 2.4.** Joe and Heather filed a joint return for 1996 showing taxable income of \$48,000 and a tax of \$8,234. Of the \$48,000 taxable income, \$40,000 was Joe's and the rest was Heather's. For 1997, they plan to file married filing separately. Joe figures his share of the tax on the 1996 joint return as follows:

Tax on \$40,000 based on a separate return .....	\$ 8,601
Tax on \$8,000 based on a separate return .....	1,204
Total .....	\$ 9,805
Joe's portion of total (\$8,601 ÷ \$9,805) .....	88%
Joe's share of joint return tax (\$8,234 × 88%) .....	<u>\$ 7,246</u>

**Estates and trusts.** Estates and trusts also must make estimated tax payments. However, estates (and certain grantor trusts that receive the residue of the decedent's estate under the decedent's will) are exempt from paying estimated tax for the first two years after the decedent's death.

Estates and trusts must use **Form 1041-ES, Estimated Income Tax for Estates and Trusts**, to figure and pay estimated tax.

## How To Figure Estimated Tax

### Completing the 1997 Estimated Tax Worksheet

To figure your estimated tax, you must figure your expected adjusted gross income, taxable income, taxes, and credits for the year.

When figuring your 1997 estimated tax, it may be helpful to use your income, deductions, and credits for 1996 as a starting point. Use your 1996 federal tax return as a guide. You will also need Form 1040-ES to figure and pay your estimated tax.

You must make adjustments both for changes in your own situation and for recent changes in the tax law. For 1997, there are several important changes in the law. These changes are discussed under *Important Changes for 1997* at the beginning of this publication.

**Form 1040-ES** includes a worksheet to help you figure your estimated tax. Keep the worksheet for your records. *Example 2.9* illustrates the use of the worksheet. A blank worksheet appears later in this chapter.

## Expected Adjusted Gross Income

Your expected adjusted gross income for 1997 (line 1 of the 1997 Estimated Tax Worksheet) is your expected total income minus your expected adjustments to income.

**Total income.** Include in your total income all the income you expect to receive during the year, even income that is subject to withholding. However, do not include income that is tax exempt.

Total income is all the items of income and loss that for 1996 are included in the total on line 22 of Form 1040, line 14 of Form 1040A, or line 4 of Form 1040EZ. When figuring your net earnings from self-employment, be sure to use only 92.35% of your total net profit from self-employment.



**Social security and railroad retirement benefits.** If you expect to receive social security or railroad retirement benefits during the year, use *Worksheet 2.1* to figure the amount of expected taxable benefits you should include on line 1 of the 1997 Estimated Tax Worksheet.

**Note.** If you are a nonresident alien, do not use *Worksheet 2.1*. Instead, include 85% of your gross benefits on line 1 of the 1997 Estimated Tax Worksheet.

**Worksheet 2.1**

1. Enter your expected social security and railroad retirement benefits .... \_\_\_\_\_
2. Enter one-half of line 1 ..... \_\_\_\_\_
3. Enter your expected total income. Do not include any social security and railroad retirement benefits, nontaxable interest income, nontaxable IRA distributions, or nontaxable pension distributions \_\_\_\_\_
4. Enter your expected nontaxable interest income ..... \_\_\_\_\_
5. Add lines 2, 3, and 4 ..... \_\_\_\_\_
6. Enter your expected adjustments to income ..... \_\_\_\_\_
7. Subtract line 6 from line 5 ..... \_\_\_\_\_
8. Enter \$25,000 (\$32,000 if you expect to file married filing a joint return; \$0 if you expect to file married filing a separate return and expect to live with your spouse at any time in 1997) ..... \_\_\_\_\_
9. Subtract line 8 from line 7. If zero or less, stop here. Do not include any social security or railroad retirement benefits on line 1 of your 1997 Estimated Tax Worksheet ..... \_\_\_\_\_
10. Enter \$9,000 (\$12,000 if you expect to file married filing a joint return; \$0 if you expect to file married filing a separate return and expect to live with your spouse at any time in 1997) ..... \_\_\_\_\_
11. Subtract line 10 from line 9. If zero or less, enter -0- ..... \_\_\_\_\_
12. Enter the smaller of line 9 or line 10 \_\_\_\_\_
13. Enter one-half of line 12 ..... \_\_\_\_\_
14. Enter the smaller of line 2 or line 13 \_\_\_\_\_

15. Multiply line 11 by 85% (.85). If line 11 is zero, enter -0- ..... \_\_\_\_\_
16. Add lines 14 and 15 ..... \_\_\_\_\_
17. Multiply line 1 by 85% (.85) ..... \_\_\_\_\_
18. Enter the smaller of line 16 or line 17. This is the amount of your expected taxable social security and railroad retirement benefits. Include this amount on line 1 of your 1997 Estimated Tax Worksheet ... \_\_\_\_\_

**Adjustments to income.** Be sure to subtract from your expected total income all of the adjustments you expect to take on your 1997 tax return. If you are using your 1996 return as a guide and filed Form 1040, your adjustments for 1996 were on lines 23a-30. If you filed Form 1040A, your 1996 adjustments were on lines 15a-15c. When estimating your 1997 adjustments, include any allowable contributions to a medical savings account.



**Self-employed.** If you expect to have income from self-employment, use the following worksheet to figure your expected self-employment tax. The result on line 10 of the worksheet is your deduction for one-half of your self-employment tax. Include this amount in the adjustments you subtract from your total income to arrive at your expected AGI. If you file a joint return and both you and your spouse have net earnings from self-employment, you must complete one worksheet for each of you.

**Worksheet 2.2**

1. Enter your expected income and profits subject to self-employment tax ..... \_\_\_\_\_
  2. Multiply the amount on line 1 by .9235 ..... \_\_\_\_\_
  3. Multiply the amount on line 2 by .029 ..... \_\_\_\_\_
  4. Social security tax maximum income ..... \$ 65,400
  5. Enter your expected wages (if subject to social security tax) ..... \_\_\_\_\_
  6. Subtract line 5 from line 4 ..... \_\_\_\_\_
- Note.** If line 6 is zero or less, enter -0- on line 8 and skip to line 9.
7. Enter the smaller of line 2 or line 6 ..... \_\_\_\_\_
  8. Multiply the amount on line 7 by .124 ..... \_\_\_\_\_
  9. Add line 3 and line 8. Enter the result here and on line 11 of your 1997 Estimated Tax Worksheet ... \_\_\_\_\_
  10. Multiply the amount on line 9 by .50. This is your deduction for one-half your self-employment tax. .... \_\_\_\_\_

**Expected Taxable Income**

After you have figured your expected adjusted gross income for 1997, you must reduce it by either your expected itemized deductions or your standard deduction and by your exemptions (lines 2 through 5 of the 1997 Estimated Tax Worksheet).

**Itemized deductions.** If you expect to claim itemized deductions on your 1997 tax return, subtract their expected total from your expected adjusted gross income.

Itemized deductions are the deductions that can be claimed on Schedule A of Form 1040.



**Reduction of itemized deductions.** For 1997, your total itemized deductions may be reduced if your adjusted gross income (AGI) is more than \$121,200 (\$60,600 if married filing separately). If you expect your AGI to be more than that amount, use the following worksheet to figure the amount to enter on line 2 of the 1997 Estimated Tax Worksheet.

**Worksheet 2.3**

1. Enter the estimated total of your itemized deductions ..... \_\_\_\_\_
2. Enter the amount included in line 1 for medical and dental expenses, investment interest, casualty or theft losses, and gambling losses \_\_\_\_\_
3. Subtract line 2 from line 1 ..... \_\_\_\_\_

**Note.** If the amount on line 3 is zero, stop here and enter the amount from line 1 of this worksheet on line 2 of the 1997 Estimated Tax Worksheet.

4. Multiply the amount on line 3 by .80 \_\_\_\_\_
5. Enter the amount from line 1 of the 1997 Estimated Tax Worksheet ... \_\_\_\_\_
6. Enter \$121,200 (\$60,600 if married filing separately) ..... \_\_\_\_\_
7. Subtract line 6 from line 5 ..... \_\_\_\_\_
8. Multiply the amount on line 7 by .03 \_\_\_\_\_
9. Enter the smaller of line 4 or line 8 \_\_\_\_\_
10. Subtract line 9 from line 1. Enter the result here and on line 2 of the 1997 Estimated Tax Worksheet ..... \_\_\_\_\_

**Standard deduction.** If you expect to claim the standard deduction on your 1997 tax return, subtract it from your expected adjusted gross income. Use the *1997 Standard Deduction Tables* at the end of this chapter to find your 1997 standard deduction.

**No standard deduction.** The standard deduction for some individuals is zero. Your standard deduction will be zero if you:

- 1) File a separate return and your spouse itemizes deductions,
- 2) Are a nonresident alien, or
- 3) Make a return for a period of less than 12 months because you change your accounting period.

**Exemptions.** After you have subtracted either your expected itemized deductions or your standard deduction from your expected adjusted gross income, reduce the amount remaining by \$2,650 for each exemption you expect to take on your 1997 tax return (lines 4 and 5 of the 1997 Estimated Tax Worksheet). If you can be claimed as a dependent on another person's return (such as your parent's return), you cannot claim your own personal exemption. This is true even if the other person will not claim your exemption or the exemption will be reduced or eliminated under the phaseout rule.

**Phaseout.** For 1997, your deduction for personal exemptions is phased out if your adjusted gross income (AGI) falls within the following brackets.

**Table 2.1**

Single	\$121,200 –	\$243,700
Married filing jointly or qualifying widow(er)	\$181,800 –	\$304,300
Married filing separately	\$ 90,900 –	\$152,150
Head of household	\$151,500 –	\$274,000

If the amount on line 1 of your 1997 Estimated Tax Worksheet is more than the highest amount in the bracket for your filing status, enter “–0–” on line 4 of your 1997 Estimated Tax Worksheet. If your AGI will fall within the bracket, use the following worksheet to figure the amount to enter on line 4 of your 1997 Estimated Tax Worksheet.



**Worksheet 2.4**

- Multiply \$2,650 by the number of exemptions you plan to claim \_\_\_\_\_
- Enter the amount from line 1 of your 1997 Estimated Tax Worksheet \_\_\_\_\_
- Enter:
  - \$121,200 if single
  - \$181,800 if married filing jointly or qualifying widow(er)
  - \$90,900 if married filing separately
  - \$151,500 if head of household \_\_\_\_\_
- Subtract line 3 from line 2 \_\_\_\_\_
- Divide the amount on line 4 by \$2,500 (\$1,250 if married filing separately). If the result is not a whole number, increase it to the next whole number \_\_\_\_\_
- Multiply the number on line 5 by .02. Enter the result as a decimal, but not more than 1 \_\_\_\_\_
- Multiply the amount on line 1 by the decimal on line 6 \_\_\_\_\_
- Subtract line 7 from line 1. Enter the result here and on line 4 of your 1997 Estimated Tax Worksheet \_\_\_\_\_

## Expected Taxes and Credits

After you have figured your expected taxable income, follow the steps below to figure your expected taxes, credits, and total tax for 1997. Most people will have entries for only a few of these steps. However, you should check every step to be sure.

**Step 1. Figure your expected income tax** (line 6 of the 1997 Estimated Tax Worksheet). Use the 1997 Tax Rate Schedules at the end of this chapter or in the instructions to Form 1040–ES to figure your expected income tax. You must use a special method to figure tax on the income of a child under age 14 who has more than \$1,300 of investment income. See *Tax on Investment Income of Child Under 14* in Publication 929, *Tax Rules for Children and Dependents*.

**Tax on net capital gain.** Your net capital gains are taxed at a maximum tax rate of 28% even if you have income subject to a higher rate. You have net capital gains if your net long-term capital gain is more than your net short-term capital loss. Use Worksheet 2.5 to figure your tax if you have net capital gains and the amount on line 5 of the 1997 Estimated Tax Worksheet is more than the amount shown for your filing status in the following table.

**Table 2.2**

Single	\$ 59,750
Married filing jointly or qualifying widow(er)	\$ 99,600
Married filing separately	\$ 49,800
Head of household	\$ 85,350



**Worksheet 2.5**

- Enter the amount from line 5 of your 1997 Estimated Tax Worksheet \_\_\_\_\_
- Enter net capital gain included in line 1 of your 1997 Estimated Tax Worksheet \_\_\_\_\_
- Enter the amount of net capital gain from the disposition of property held for investment that you elect to include in investment income for purposes of figuring the limit on investment interest. (Do not include more than the total net gain from the disposition of property held for investment.) \_\_\_\_\_
- Subtract line 3 from line 2. If zero or less, stop here. Figure the tax on the amount on line 1 using the 1997 Tax Rate Schedules and enter the result on line 6 of the 1997 Estimated Tax Worksheet \_\_\_\_\_
- Subtract line 4 from line 1 \_\_\_\_\_

- Enter:
  - \$24,650 if single
  - \$41,200 if married filing jointly or qualifying widow(er)
  - \$20,600 if married filing separately
  - \$33,050 if head of household \_\_\_\_\_
- Enter the larger of line 5 or line 6 \_\_\_\_\_
- Subtract line 7 from line 1 \_\_\_\_\_
- Figure the tax on the amount on line 7 using the 1997 Tax Rate Schedules, and enter the result \_\_\_\_\_
- Multiply the amount on line 8 by .28 \_\_\_\_\_
- Add line 9 and line 10 \_\_\_\_\_
- Figure the tax on the amount on line 1 using the 1997 Tax Rate Schedules \_\_\_\_\_
- Enter the smaller of line 11 or line 12 here and on line 6 of the 1997 Estimated Tax Worksheet \_\_\_\_\_

**Step 2. Add your expected additional taxes** (lines 7 and 8 of the 1997 Estimated Tax Worksheet). Additional taxes are the ones from Form 8814, *Parents' Election To Report Child's Interest and Dividends*, and Form 4972, *Tax on Lump-Sum Distributions* (lines 38a and 38b of the 1996 Form 1040).

**Step 3. Subtract your expected credits** (lines 9 and 10 of the 1997 Estimated Tax Worksheet). If you are using your 1996 return as a guide and filed Form 1040, your total credits for 1996 were shown on line 43. If you filed Form 1040A, your total credits for 1996 were on line 24c. When estimating your 1997 credits, include any allowable adoption tax credit. If your credits on line 9 of the worksheet are more than your taxes on line 8, enter “–0–” on line 10 and go on to Step 4.

**Step 4. Add your expected self-employment tax and other taxes** (lines 11 through 13a of the 1997 Estimated Tax Worksheet). You should have already figured your self-employment tax (see *Expected Adjusted Gross Income* earlier in this chapter).

“Other taxes” are those shown on lines 46 and 48 of the 1996 Form 1040, plus any advance earned income credit payments on line 49 and any write-in amounts on line 51 (other than recapture of a federal mortgage subsidy and any uncollected social security, Medicare, or railroad retirement tax).

If you filed a 1996 Form 1040A, your only “other taxes” were any advance earned income credit payments on line 26.

**Step 5. Subtract your expected earned income credit and Form 4136 fuel tax credit** (lines 13b and 13c of the 1997 Estimated Tax Worksheet). These are shown on lines 54 and 57b of the 1996 Form 1040. The earned income credit is shown on line 29c of the 1996 Form 1040A. To figure your expected fuel tax credit, do not include fuel tax for the first three quarters of the year that you expect to have refunded to you.

## 1997 Estimated Tax Worksheet (keep for your records)

1 Enter amount of adjusted gross income you expect in 1997 (see instructions) . . . . .	1		
2 • If you plan to itemize deductions, enter the estimated total of your itemized deductions. Caution: If line 1 above is over \$121,200 (\$60,600 if married filing separately), your deduction may be reduced. See Pub. 505 for details. • If you do not plan to itemize deductions, see <b>Standard Deduction for 1997</b> on page 2, and enter your standard deduction here.	2		
3 Subtract line 2 from line 1 . . . . .	3		
4 Exemptions. Multiply \$2,650 by the number of personal exemptions. If you can be claimed as a dependent on another person's 1997 return, your personal exemption is not allowed. Caution: If line 1 above is over \$181,800 (\$151,500 if head of household; \$121,200 if single; \$90,900 if married filing separately), see Pub. 505 to figure the amount to enter . . . . .	4		
5 Subtract line 4 from line 3 . . . . .	5		
6 Tax. Figure your tax on the amount on line 5 by using the 1997 Tax Rate Schedules on page 2. DO NOT use the Tax Table or the Tax Rate Schedules in the 1996 Form 1040 or Form 1040A instructions. Caution: If you have a net capital gain and line 5 is over \$99,600 (\$85,350 if head of household; \$59,750 if single; \$49,800 if married filing separately), see Pub. 505 to figure the tax	6		
7 Additional taxes (see instructions) . . . . .	7		
8 Add lines 6 and 7 . . . . .	8		
9 Credits (see instructions). Do not include any income tax withholding on this line . . . . .	9		
10 Subtract line 9 from line 8. Enter the result, but not less than zero . . . . .	10		
11 Self-employment tax (see instructions). Estimate of 1997 net earnings from self-employment \$. . . . . ; if \$85,400 or less, multiply the amount by 15.3%; if more than \$85,400, multiply the amount by 2.9%, add \$8,109.60 to the result, and enter the total. Caution: If you also have wages subject to social security tax, see Pub. 505 to figure the amount to enter . . . . .	11		
12 Other taxes (see instructions), . . . . .	12		
13a Add lines 10 through 12 . . . . .	13a		
b Earned income credit and credit from Form 4136 . . . . .	13b		
c Subtract line 13b from line 13a. Enter the result, but not less than zero. <b>THIS IS YOUR TOTAL 1997 ESTIMATED TAX</b> . . . . . ▶	13c		
14a Multiply line 13c by 90% (66⅔% for farmers and fishermen) . . . . .	14a		
b Enter the tax shown on your 1996 tax return (110% of that amount if you are not a farmer or a fisherman and the adjusted gross income shown on that return is more than \$150,000 or, if married filing separately for 1997, more than \$75,000) . . . . .	14b		
c Enter the smaller of line 14a or 14b. <b>THIS IS YOUR REQUIRED ANNUAL PAYMENT TO AVOID A PENALTY</b> . . . . . ▶ Caution: Generally, if you do not prepay (through income tax withholding and estimated tax payments) at least the amount on line 14c, you may owe a penalty for not paying enough estimated tax. To avoid a penalty, make sure your estimate on line 13c is as accurate as possible. Even if you pay the required annual payment, you may still owe tax when you file your return. If you prefer, you may pay the amount shown on line 13c. For more details, see Pub. 505.	14c		
15 Income tax withheld and estimated to be withheld during 1997 (including income tax withholding on pensions, annuities, certain deferred income, etc.) . . . . .	15		
16 Subtract line 15 from line 14c. (Note: If zero or less, or line 13c minus line 15 is less than \$500, stop here. You are not required to make estimated tax payments.) . . . . .	16		
17 If the first payment you are required to make is due April 15, 1997, enter ¼ of line 16 (minus any 1996 overpayment that you are applying to this installment) here and on your payment voucher(s)	17		

The result of steps 1 through 5 is your **total expected tax** for 1997 (line 13c of the 1997 Estimated Tax Worksheet).

## Required Annual Payment

You figure the total amount you must pay for 1997 through withholding and estimated tax payments on lines 14a through 14c of the 1997 Estimated Tax Worksheet.

**General rule.** The total amount you must pay is the **smaller** of:

- 1) 90% of your total expected tax for 1997, or
- 2) 100% of the total tax shown on your 1996 return. Your 1996 tax return must cover all 12 months.

**Exceptions.** There are exceptions to the general rule for farmers and fishermen and for certain higher income taxpayers.

**Farmers and fishermen.** If at least two-thirds of your gross income for 1996 or 1997 is from farming or fishing, see *Farmers and Fishermen* later.

**Higher income taxpayers.** If less than two-thirds of your gross income for 1996 and 1997 is from farming or fishing and your adjusted gross income (AGI) for 1996 was more than \$150,000 (\$75,000 if your filing status for 1997 is married filing a separate return), substitute 110% for 100% in (2) above.

For 1996, AGI is the amount shown on Form 1040 – line 31; Form 1040A – line 16; and Form 1040EZ – line 4.

**Total tax for 1996.** Your 1996 total tax on Form 1040 is the amount on line 51 reduced by the total of the amounts on lines 47, 50, and 54, any credit from Form 4136 included on line 57, any recapture of a federal mortgage subsidy and any uncollected social security, Medicare, or railroad retirement tax included on line 51, and any tax from Form 5329 (other than the tax on early distributions) included on line 48. On Form 1040A, it is line 28 reduced by the amounts on lines 27 and 29c. On Form 1040EZ, it is line 10 reduced by line 8.

**Example 2.5.** Jeremy Martin's total tax on his 1996 return was \$45,000, and his expected tax for 1997 is \$70,000. His 1996 AGI was \$180,000. Because Jeremy had more than \$150,000 of AGI in 1996, he figures his required annual payment as follows.

- 1) He determines that 90% of his expected tax for 1997 is \$63,000 ( $.90 \times \$70,000$ ).
- 2) Next, he determines that 110% of the tax shown on his 1996 return is \$49,500 ( $1.10 \times \$45,000$ ).
- 3) Finally, he determines that his required annual payment is \$49,500, the smaller of (1) or (2).

## Farmers and Fishermen

If at least two-thirds of your gross income for 1996 or 1997 is from farming or fishing, your required annual payment is the smaller of:

- 1) 66 $\frac{2}{3}$ % (.6667) of your total tax for 1997, or
- 2) 100% of the total tax shown on your 1996 return. (Your 1996 tax return must cover all 12 months.)

For definitions of "gross income from farming" and "gross income from fishing," see *Farmers and Fishermen* later under *When To Pay Estimated Tax*.

## Total Estimated Tax Payments

Figure the total amount you must pay for 1997 through estimated tax payments on lines 15 and 16 of the 1997 Estimated Tax Worksheet. Subtract your expected withholding from your required annual payment. You usually must pay this difference in four equal installments. (See *When To Pay Estimated Tax and How To Figure Each Payment*, later.)

If your total expected tax on line 13c, minus your expected withholding on line 15, is less than \$500, you do not need to make estimated tax payments.

**Withholding.** Your expected withholding for 1997 includes the income tax you expect to be withheld from all sources (wages, pensions and annuities, etc.). It also includes excess social security and railroad retirement tax you expect to be withheld from your wages.

For this purpose, you will have excess social security or tier 1 railroad retirement tax withholding for 1996 only if your wages from two or more employers are more than \$65,400.

## When To Pay Estimated Tax

For estimated tax purposes, the year is divided into four payment periods. Each period has a specific payment due date. If you do not pay enough tax by the due date of each of the payment periods, you may be charged a penalty even if you are due a refund when you file your income tax return. The following chart gives the payment periods and due dates for estimated tax payments.

**Table 2.3**

For the period:	Due date:
January 1* through March 31	April 15
April 1 through May 31	June 15
June 1 through August 31	September 15
September 1 through December 31	January 15 next year**

\*If your tax year does not begin on January 1, see *Fiscal year taxpayers*, later.

\*\*See *January payment*, later.

**Saturday, Sunday, holiday rule.** If the due date for making an estimated tax payment falls on a Saturday, Sunday, or legal holiday, the payment will be on time if you make it on the next day that is not a Saturday, Sunday, or legal holiday. For example, a payment due Sunday, June 15, 1997, will be on time if you make it by Monday, June 16, 1997.

**January payment.** If you file your 1997 Form 1040 or Form 1040A by February 2, 1998, and pay the rest of the tax you owe, you do not need to make your estimated tax payment that would be due on January 15, 1998.

**Example 2.6.** Janet Adams does not pay any estimated tax due for 1997. She files her 1997 income tax return and pays the balance due as shown on her return on January 22, 1998.

Janet's estimated tax for the fourth payment period is considered to have been paid on January 15, 1998. If she must pay a penalty for not making 1997 estimated tax payments, she will have no penalty for that period. Any penalty for the other payment periods will be figured up to January 22, 1998.

**Fiscal year taxpayers.** If your tax year does not start on January 1, your payment due dates are:

- 1) The 15th day of the 4th month of your fiscal year,
- 2) The 15th day of the 6th month of your fiscal year,
- 3) The 15th day of the 9th month of your fiscal year, and
- 4) The 15th day of the 1st month after the end of your fiscal year.

You do not have to make the last payment listed above if you file your income tax return by the last day of the first month after the end of your fiscal year and pay all the tax you owe with your return.

## When To Start

You do not have to make estimated tax payments until you have income on which you will owe the tax. If you have income subject to estimated tax during the first payment period, you must make your first payment by the due date for the first payment period. You can pay all your estimated tax at that time, or you can pay it in four installments. If you choose to pay in installments, make your first payment by the due date for the first payment period. Make your remaining installment payments by the due dates for the later periods.

**No income subject to estimated tax during first period.** If you first have income subject to estimated tax during a later payment period, you must make your first payment by the due date for that period. You can pay your entire estimated tax by the due date for that period or you can pay it in installments by the due date for that period and the due dates for the remaining periods. The following chart shows the dates for making installment payments.

**Table 2.4**

If you first have income on which you must pay estimated tax:	Make a payment by:	Make later installments by:
Before April 1	April 15	June 15 September 15 January 15 next year*
After March 31 and before June 1	June 15	September 15 January 15 next year*
After May 31 and before Sept. 1	September 15	January 15 next year*
After August 31	January 15 next year*	(None)

\*See *January payment and Saturday, Sunday, holiday rule* under *When To Pay Estimated Tax*, earlier.

**Change in estimated tax.** After making your first estimated tax payment, changes in your income, adjustments, deductions, credits, or exemptions may make it necessary for you to refigure your estimated tax. Pay the unpaid balance of your amended estimated tax by the next payment due date after the change or in installments by that date and the due dates for the remaining payment periods.

**How much to pay to avoid penalty.** To determine how much you should pay by each payment due date, see *How To Figure Each Payment*, later. If the earlier discussions of *No income subject to estimated tax during first period* or *Change in estimated tax* apply to you, you may need to read the explanation of the *Annualized Income Installment Method* to avoid a penalty.

## Farmers and Fishermen

If at least two-thirds of your gross income for 1996 or 1997 is from farming or fishing, you have only one payment due date for your 1997 estimated tax — January 15, 1998. The due dates for the first three payment periods, discussed earlier under *When To Pay Estimated Tax*, do not apply to you.

If you file your 1997 Form 1040 by March 2, 1998, and pay all the tax you owe, you do not need to pay estimated tax.

**Joint returns.** On a joint return, you must add your spouse's gross income to your gross income to determine if at least two-thirds of your total gross income is from farming or fishing.

**Gross income.** Your gross income is all income you receive in the form of money, goods, property, and services that is not exempt from tax. To decide whether two-thirds

of your gross income for 1996 was from farming or fishing, use as your gross income the total of the **income** (not loss) amounts from:

- 1) Form 1040, lines 7, 8a, 9, 10, 11, 15b, 16b, 19, 20b, and 21;
- 2) Schedule C (Form 1040), line 7;
- 3) Schedule C–EZ (Form 1040), line 1;
- 4) Schedule D (Form 1040), column (g) of lines 7 and 16, less column (g) of lines 5 and 13, and any gain from Form 4797 reported on line 12;
- 5) Schedule E (Form 1040), lines 3, 4, 36, and 38;
- 6) Schedule F (Form 1040), line 11;
- 7) Form 4797, column (h) of lines 7 and 19;
- 8) Form 4835, line 7; and
- 9) Schedule K–1 (Form 1065), lines 15b and 15c (less any partnership amounts included in (1) through (7)).

Also add your pro rata share of S corporation gross income (less any S corporation amounts included in (1) through (7)).

**Gross income from farming.** This is income from cultivating the soil or raising agricultural commodities. It includes the following:

- 1) Income from operating a stock, dairy, poultry, bee, fruit, or truck farm,
- 2) Income from a plantation, ranch, nursery, range, orchard, or oyster bed,
- 3) Crop shares for the use of your land, and
- 4) Gains from sales of draft, breeding, dairy, or sporting livestock.

For 1996, gross income from farming is the total of the amounts from line 11 of Schedule F (Form 1040), *Farm Income and Expenses*, and line 7 of Form 4835, *Farm Rental Income and Expenses*, plus your share of a partnership's or S corporation's gross income from farming, your share of distributable net income from farming of an estate or trust, and your gains from sales of draft, breeding, dairy, or sporting livestock shown on Form 4797.

Wages you receive as a farm employee and wages you receive from a farm corporation are not gross income from farming.

**Gross income from fishing.** This is income from catching, taking, harvesting, cultivating, or farming any kind of fish, shellfish (for example, clams and mussels), crustaceans (for example, lobsters, crabs, and shrimp), sponges, seaweeds, or other aquatic forms of animal and vegetable life.

Gross income from fishing includes the following:

- 1) Income for services as an officer or crew member of a vessel while the vessel is engaged in fishing,
- 2) Your share of a partnership's or S corporation's gross income from fishing, and
- 3) Income for services normally performed in connection with fishing.

Services normally performed in connection with fishing include shore service as an officer or crew member of a vessel engaged in fishing and services that are necessary for the immediate preservation of the catch, such as cleaning, icing, and packing the catch.

**Fiscal year farmers and fishermen.** If you are a farmer or fisherman, but your tax year does not start on January 1, you can either:

- 1) Pay all your estimated tax by the 15th day after the end of your tax year, or
- 2) File your return and pay all the tax you owe by the 1st day of the 3rd month after the end of your tax year.

## How To Figure Each Payment

After you have figured your estimated tax, figure how much you must pay by the due date of each payment period. You should pay enough by each due date to avoid a penalty for that period. If you do not pay enough during each payment period, you may be charged a penalty even if you are due a refund when you file your tax return. The penalty is discussed in Chapter 4.

### Regular Installment Method

If you must pay estimated tax beginning with the payment due April 15, 1997, you can figure your required payment for each period by dividing your total estimated tax payments (line 16 of the 1997 Estimated Tax Worksheet) by 4. Use this method only if your required annual payment stays the same throughout the year.

If you do not receive your income evenly throughout the year, your required estimated tax payments may not be the same for each period. See *Annualized Income Installment Method*, later.



**Amended estimated tax.** If you refigure your estimated tax during the year, or if your first estimated tax payment is due after April 15, 1997, figure your required payment for each remaining payment period using the following worksheet.

**Worksheet 2.6**

1. Amended total estimated tax .....
2. Multiply line 1 by:
  - .50 if next payment is due June 16, 1997
  - .75 if next payment is due September 15, 1997
  - 1.00 if next payment is due January 15, 1998 .....
3. Estimated tax payments for all previous periods .....

4. **Next required payment:** Subtract line 3 from line 2 and enter the result (but not less than zero) here and on your payment-voucher for your next required payment .....

If the payment on line 4 is due January 15, 1998, **stop here.** Otherwise, go on to line 5.

5. Add lines 3 and 4 .....

6. Subtract line 5 from line 1 and enter the result (but not less than zero) .....

7. **Each following required payment:** If the payment on line 4 is due June 16, 1997, enter one-half of the amount on line 6 here and on the payment-vouchers for your payments due September 15, 1997, and January 15, 1998. If the amount on line 4 is due September 15, 1997, enter the full amount on line 6 here and on the payment-voucher for your payment due January 15, 1998 .....

**Example 2.7.** Early in 1997, Mayra figures her estimated tax is \$1,800. She makes estimated tax payments on April 15 and June 16 of \$450 each ( $\$1,800 \div 4$ ).

On July 10, she sells investment property at a gain. Her refigured estimated tax is \$4,100. Her required estimated tax payment for the third payment period is \$2,175, figured as follows.

**Filled-in Worksheet 2.6 for Mayra  
(Example 2.7)**

1. Amended total estimated tax ..... \$4,100

2. Multiply line 1 by:  
     .50 if next payment is due  
     June 16, 1997  
     .75 if next payment is due  
     September 15, 1997  
     1.00 if next payment is due  
     January 15, 1998 ..... 3,075

3. Estimated tax payments for all  
 previous periods ..... 900

4. **Next required payment:** Subtract line 3 from line 2 and enter the result (but not less than zero) here and on your payment-voucher for your next required payment ..... \$2,175

If the payment on line 4 is due January 15, 1998, **stop here.** Otherwise, go on to line 5.

5. Add lines 3 and 4 ..... 3,075

6. Subtract line 5 from line 1 and enter the result (but not less than zero) ..... 1,025

7. **Each following required payment:** If the payment on line 4 is due June 16, 1997, enter one-half of the amount on line 6 here and on the payment-vouchers for your payments due September 15, 1997, and January 15, 1998. If the amount on line 4 is due September 15, 1997, enter the full amount on line 6 here and on the payment-voucher for your payment due January 15, 1998 ..... \$1,025

If Mayra's estimated tax does not change again, her required estimated tax payment for the fourth payment period will be \$1,025.

**File Form 2210 to avoid penalty.** If your estimated tax payment for a previous period is less than one-fourth of your amended estimated tax, you may be charged a penalty for underpayment of estimated tax for that period when you file your tax return. To avoid the penalty, you must file Form 2210 with your 1997 tax return. You must also show that the total of your withholding and estimated tax payment for the period was at least as much as your annualized income installment. See Chapter 4 for more information.

**Annualized Income  
Installment Method**

If you do not receive your income evenly throughout the year (for example, your income from a repair shop you operate is much larger in the summer than it is during the rest of the year), your required estimated tax payment for one or more periods may be less than the amount figured using the regular installment method.

To see if you can pay less for any period, complete the blank *1997 Annualized Estimated Tax Worksheet (Worksheet 2.10)* later in this chapter. (**Note:** You must first complete the *1997 Estimated Tax Worksheet* through line 16.) The worksheet annualizes your tax at the end of each period based on a reasonable estimate of your income, deductions, and other items relating to events that occurred since the beginning of the tax year through the end of the period. Use the result you figure on line 26d to make your estimated tax payments and complete your payment-vouchers.

See *Example 2.10* for an illustration of the worksheet.

**Note.** If you use the annualized income installment method to figure your estimated tax payments, you **must** file Form 2210 with your 1997 tax return. See *Annualized Income Installment Method* in Chapter 4 for more information.

**Instructions For Worksheet 2.10**

The top of the worksheet shows the dates for each payment period. The periods build; that is, each period includes all previous periods. After the end of each payment period, complete the worksheet column for the period from the beginning of the tax year through the end of that payment period to figure how much

estimated tax to pay by the payment due date for that period.

**Line 1.** Enter your adjusted gross income for each period. This is your gross income, including your share of partnership or S corporation income or loss, for the period, minus your adjustments to income for that period. (See *Expected Adjusted Gross Income* under *How To Figure Estimated Tax*, earlier.)

**Self-employment income.** If you had self-employment income, first complete Section B. Enter your self-employment tax for each period on line 13 of Section A. Use the amount on line 35c when figuring your adjusted gross income for the period.

**Line 4.** Be sure to consider all deduction limits figured on Schedule A, lines 1 – 27.

**Line 6.** Multiply line 4 by line 5 and enter the result on line 6, unless line 3 is more than \$121,200 (\$60,600 if married filing separately). In that case, use the following worksheet to figure the amount to enter on line 6. Complete this worksheet for each period.



**Worksheet 2.7**

1. Enter the amount from line 4 of Section A .....

2. Enter the amount included in line 1 for medical and dental expenses, investment interest, casualty or theft losses, and gambling losses .....

3. Subtract line 2 from line 1 .....

4. Enter the number from line 5 of Section A .....

5. Multiply the amount on line 1 by the number on line 4 .....

**Note.** If the amount on line 3 is zero, stop here and enter the amount from line 5 on line 6 of Section A.

6. Multiply the amount on line 3 by the number on line 4 .....

7. Multiply the amount on line 6 by .80 .....

8. Enter the amount from line 3 of Section A .....

9. Enter \$121,200 (\$60,600 if married filing separately) .....

10. Subtract line 9 from line 8 .....

11. Multiply the amount on line 10 by .03 .....

12. Enter the smaller of line 7 or line 11 .....

13. Subtract line 12 from line 5. Enter the result here and on line 6 of Section A .....

**Line 7.** See the *1997 Standard Deduction Tables* at the end of this chapter. Find your standard deduction in the appropriate table.

Worksheet 2.10. **1997 Annualized Estimated Tax Worksheet** (Note: For instructions, see Annualized Income Installment Method in Chapter 2.)

<b>Section A (For Figuring Your Annualized Estimated Tax Payments)</b> —Complete each column after end of period shown.					
<b>Estates and trusts:</b> Use the following ending dates in each column—2/28, 4/30, 7/31, 11/30.		<b>1/1/97 to 3/31/97</b>	<b>1/1/97 to 5/31/97</b>	<b>1/1/97 to 8/31/97</b>	<b>1/1/97 to 12/31/97</b>
<b>1</b> Adjusted gross income for the period. ( <b>Caution:</b> See instructions.) Self-employed: Complete Section B first.	<b>1</b>				
<b>2</b> Annualization amounts. (Estates and trusts, <b>do not</b> use the amounts shown to right. Instead, use 6, 3, 1.71429, and 1.09091.)	<b>2</b>	4	2.4	1.5	1
<b>3</b> Multiply line 1 by line 2.	<b>3</b>				
<b>4</b> Itemized deductions for period. If you do not expect to itemize, skip to line 6 and enter zero.	<b>4</b>				
<b>5</b> Annualization amounts. (Estates and trusts, <b>do not</b> use the amounts shown to right. Instead, use 6, 3, 1.71429, and 1.09091.)	<b>5</b>	4	2.4	1.5	1
<b>6</b> Multiply line 4 by line 5. ( <b>Caution:</b> See instructions and Worksheet 2.7.)	<b>6</b>				
<b>7</b> Standard deduction from 1997 tables.	<b>7</b>				
<b>8</b> Enter the larger of line 6 or line 7.	<b>8</b>				
<b>9</b> Subtract line 8 from line 3.	<b>9</b>				
<b>10</b> Multiply \$2,650 by your total expected exemptions. ( <b>Caution:</b> See instructions and Worksheet 2.8.)	<b>10</b>				
<b>11</b> Subtract line 10 from line 9.	<b>11</b>				
<b>12</b> Tax on the amount on line 11 from the 1997 Tax Rate Schedules. ( <b>Caution:</b> See instructions and Worksheet 2.9.)	<b>12</b>				
<b>13</b> Self-employment tax from line 35a of Section B.	<b>13</b>				
<b>14</b> Other taxes for the period.	<b>14</b>				
<b>15</b> Add lines 12, 13, and 14.	<b>15</b>				
<b>16</b> Credits for the period.	<b>16</b>				
<b>17</b> Total tax. Subtract line 16 from line 15. (If less than zero, enter zero.)	<b>17</b>				
<b>18</b> Applicable percentage.	<b>18</b>	22.5%	45%	67.5%	90%
<b>19</b> Multiply line 17 by line 18.	<b>19</b>				
<b>20</b> Add amounts on line 26a of all preceding columns.	<b>20</b>	//////////			
<b>21</b> Annualized income installment. Subtract line 20 from line 19. (If less than zero, enter zero.)	<b>21</b>				
<b>22</b> Divide line 14c of the Form 1040-ES Estimated Tax Worksheet by 4.	<b>22</b>				
<b>23</b> Enter amount from line 25 of preceding column.	<b>23</b>	//////////			
<b>24</b> Add lines 22 and 23.	<b>24</b>				
<b>25</b> If line 24 is more than line 21, subtract line 21 from line 24. Otherwise, enter zero.	<b>25</b>				
<b>26a</b> Enter the smaller of line 21 or line 24. ( <b>Caution:</b> See instructions.)	<b>26a</b>				
<b>b</b> Total required payments for the period. Add lines 20 and 26a.	<b>26b</b>				
<b>c</b> Estimated tax payments made (line 26d of all previous columns) and tax withholding through the due date for the period.	<b>26c</b>				
<b>d</b> Estimated tax payment required by the next due date. Subtract line 26c from line 26b and enter the result (but not less than zero) here and on your payment-voucher.	<b>26d</b>				

Worksheet 2.10 (continued) **1997 Annualized Estimated Tax Worksheet**

<b>Section B (For Figuring Your Annualized Estimated Self-Employment Tax)</b> —Complete each column after end of period shown.		<b>1/1/97 to 3/31/97</b>	<b>1/1/97 to 5/31/97</b>	<b>1/1/97 to 8/31/97</b>	<b>1/1/97 to 12/31/97</b>
<b>27a</b> Self-employment net profit for the period.	<b>27a</b>				
<b>b</b> Multiply line 27a by 92.35% and enter the result.	<b>27b</b>				
<b>c</b> Annualization amounts.	<b>27c</b>	4	2.4	1.5	1
<b>d</b> Multiply line 27b by line 27c.	<b>27d</b>				
<b>28</b> Social security tax maximum income.	<b>28</b>	\$65,400	\$65,400	\$65,400	\$65,400
<b>29</b> Social security wages and tips for the period.	<b>29</b>				
<b>30</b> Annualization amounts.	<b>30</b>	4	2.4	1.5	1
<b>31</b> Multiply line 29 by line 30.	<b>31</b>				
<b>32</b> Subtract line 31 from line 28. If zero or less, enter -0-.	<b>32</b>				
<b>33</b> Multiply the smaller of line 27d or line 32 by .124.	<b>33</b>				
<b>34</b> Multiply line 27d by .029.	<b>34</b>				
<b>35a</b> Add lines 33 and 34. Enter the result here and on line 13 of Section A.	<b>35a</b>				
<b>b</b> Annualization amounts.	<b>35b</b>	8	4.8	3	2
<b>c</b> Deduction for one-half of self-employment tax. Divide line 35a by 35b. Enter the result here. Also use this result to figure your adjusted gross income on line 1.	<b>35c</b>				

**Line 10.** Multiply \$2,650 by your total expected exemptions, unless line 3 is more than the amount shown for your filing status in the following table.

**Table 2.5**

Single	\$121,200
Married filing jointly or qualifying widow(er)	\$181,800
Married filing separately	\$ 90,900
Head of household	\$151,500

In that case, use the following worksheet to figure the amount to enter on line 10.



**Worksheet 2.8**

1. Multiply \$2,650 by your total expected exemptions \_\_\_\_\_
2. Enter the amount from line 3 of Section A \_\_\_\_\_
3. Enter the amount shown for your filing status from Table 2.5 \_\_\_\_\_
4. Subtract line 3 from line 2 \_\_\_\_\_
5. Divide the amount on line 4 by \$2,500 (\$1,250 if married filing separately). If the result is not a whole number, increase it to the next whole number \_\_\_\_\_
6. Multiply the number on line 5 by .02. Enter the result as a decimal, but not more than 1 \_\_\_\_\_
7. Multiply the amount on line 1 by the decimal on line 6 \_\_\_\_\_
8. Subtract line 7 from line 1. Enter the result here and on line 10 of Section A \_\_\_\_\_

**Line 12.** Use the *1997 Tax Rate Schedules* at the end of this chapter or in the instructions to Form 1040-ES to figure your annualized income tax. For the special method that must be used to figure tax on the income of a child under 14 who has more than \$1,300 investment income, see *Tax on Investment Income of Child Under 14* in Publication 929, *Tax Rules for Children and Dependents*.



**Schedule D tax computation.** Use the following worksheet to figure the amount to enter on line 12 if the amount on line 1 includes a **net capital gain** (net long-term capital gain is more than net short-term capital loss), and line 11 is more than the amount shown for your filing status in Table 2.2, earlier.

**Worksheet 2.9**

1. Enter the amount from line 11 of Section A \_\_\_\_\_
2. Multiply the net capital gain included in line 1 of Section A by the number on line 2 of Section A \_\_\_\_\_
3. Multiply the amount of net capital gain included in line 1 of Section A from the disposition of property held for investment that you elect to include in investment income for purposes of figuring the limit on investment interest by the number on line 2 of Section A. (Do not include more than the total net gain from the disposition of property held for investment.) \_\_\_\_\_
4. Subtract line 3 from line 2. If zero or less, stop here. Figure the tax on the amount on line 1 using the 1997 Tax Rate Schedules and enter the result on line 12 of Section A \_\_\_\_\_
5. Subtract line 4 from line 1 \_\_\_\_\_
6. Enter:
  - \$24,650 if single
  - \$41,200 if married filing jointly or qualifying widow(er)
  - \$20,600 if married filing separately
  - \$33,050 if head of household \_\_\_\_\_
7. Enter the larger of line 5 or line 6 \_\_\_\_\_
8. Subtract line 7 from line 1 \_\_\_\_\_
9. Figure the tax on the amount on line 7 using the 1997 Tax Rate Schedules, and enter the result \_\_\_\_\_
10. Multiply the amount on line 8 by .28 \_\_\_\_\_
11. Add line 9 and line 10 \_\_\_\_\_
12. Figure the tax on the amount on line 1 using the 1997 Tax Rate Schedules \_\_\_\_\_
13. Enter the smaller of line 11 or line 12 here and on line 12 of Section A \_\_\_\_\_

**Line 13.** See *Self-employment income* under *Line 1*.

**Line 14.** Include all the taxes you will owe (other than income tax and self-employment tax) because of events that occurred during the period. These include the taxes shown on lines 38a, 38b, 46, and 48 of the 1996 Form 1040, plus any advance earned income credit payments on line 49 and any write-in amounts on line 51 (other than recapture of a federal mortgage subsidy and any uncollected social security, Medicare, or railroad retirement tax).  
If you filed a 1996 Form 1040A, "other tax" is any advance earned income credit payments on line 26.

**Line 16.** Include all the credits (other than withholding credits) you can claim because of events that occurred during the period. If you are using your 1996 return as a guide and filed Form 1040, your 1996 credits included the

credit on line 54, the credit from Form 4136 included on line 57, and the credits that are included in the total on line 43. If you filed Form 1040A, your 1996 credits included the credits on lines 24a, 24b, and 29c. When estimating your 1997 credits, include any allowable adoption tax credit.

**Line 26a.** If line 24 is smaller than line 21 and line 22 is based on an estimate of your 1997 tax, the amount of which is not certain, to avoid a penalty you may want to enter on this line the amount from line 21.

**Line 26c.** Include all estimated tax payments actually made and federal income tax withholding through the payment due date for the period. Also include excess social security and excess railroad retirement for the period.

Your withholding is considered paid in four equal installments, one on the due date of each payment period. To figure the amount to include on line 26c for each period, multiply your total expected withholding for 1997 by:

- 1) 25% (.25) for the first period,
- 2) 50% (.50) for the second period,
- 3) 75% (.75) for the third period, or
- 4) 100% (1.00) for the fourth period.

You may choose to include your actual withholding through the due date for each period on line 26c. You can make this choice separately for the taxes withheld from your wages and all other withholding. For an explanation of what to include in withholding, see *Total Estimated Tax Payments* under *How To Figure Estimated Tax*, earlier.

**Section B.** If you had income from self-employment during any period, complete the worksheet column for that period to figure your annualized self-employment tax **before** you complete *Section A*.

**Nonresident aliens.** If you will file Form 1040NR and you **do not** receive wages as an employee subject to U.S. income tax withholding, the instructions for the worksheet are modified as follows:

- 1) Skip the first column.
- 2) On line 1, enter your income for the period that is effectively connected with a U.S. trade or business.
- 3) On line 17, increase your entry by the amount determined by multiplying your income for the period that is **not** effectively connected with a U.S. trade or business by the following:
  - a) 72% for the second column,
  - b) 45% for the third column, and
  - c) 30% for the fourth column.

However, if you can use a treaty rate lower than 30%, use the percentages determined by multiplying your treaty rate by 2.4, 1.5, and 1, respectively, instead of the above percentages.

- 4) On line 22, enter one-half of the amount from line 16c of the Form 1040-ES(NR)

1997 Estimated Tax Worksheet in the second column, and one-fourth in the third and fourth columns.

- On line 26c, if you do not use the actual withholding method, include one-third of your total expected withholding in the second column and two-thirds in the third and fourth columns.

See Publication 519 for more information.

## Estimated Tax Payments Not Required

You do not have to make estimated tax payments if your withholding in each payment period is at least one-fourth of your required annual payment or at least your required annualized income installment for that period. You also do not have to make estimated tax payments if you will pay enough through withholding to keep the amount you owe with your 1997 return under \$500.

## How To Pay Estimated Tax

There are three ways to make estimated tax payments:

- By crediting an overpayment** on your 1996 return to your 1997 estimated tax,
- By sending in your payment** with a payment-voucher from **Form 1040-ES**, and
- By paying electronically** using the Electronic Federal Tax Payment System (EFTPS). For EFTPS information, call 1-800-945-8400 or 1-800-555-4477.

In addition, if you are a beneficiary of an estate or trust, and the trustee elects to credit 1997 trust payments of estimated tax to you, you can treat the amount credited as paid by you on January 15, 1998.

## Crediting an Overpayment

When you file your Form 1040 or Form 1040A for 1996 and you have an overpayment of tax, you can apply part or all of it to your estimated tax for 1997. On line 61 of Form 1040, or line 32 of Form 1040A, write the amount you want credited to your estimated tax rather than refunded. The amount you have credited should be taken into account when figuring your estimated tax payments.

You can use all the credited amount toward your first payment, or you can spread it out in any way you choose among any or all of your payments.

If you ask that an overpayment be credited to your estimated tax for the next year, the payment is considered to have been made on the due date of the first estimated tax installment (April 15 for calendar year taxpayers). You cannot have any of that amount refunded to you after that due date. You also cannot use that overpayment in any other way after that date.

**Example 2.8.** When Rosa finished filling out her 1996 tax return, she saw that she had overpaid her taxes by \$750. Rosa knew she would owe additional tax in 1997. She credited \$600 of the overpayment to her 1997 estimated tax and had the remaining \$150 refunded to her.

In September, she amended her 1996 return by filing Form 1040X, *Amended U.S. Individual Income Tax Return*. It turned out that she owed \$250 more in tax than she had thought. This reduced her 1996 overpayment from \$750 to \$500. Because the \$750 had already been applied to her 1997 estimated tax or refunded to her, the IRS billed her for the additional \$250 she owed, plus penalties and interest. Rosa could not use any of the \$600 she had credited to her 1997 estimated tax to pay this bill.

## Using the Payment-Vouchers

Each payment of estimated tax must be accompanied by a payment-voucher from Form 1040-ES. If you made estimated tax payments last year, you should receive a copy of the 1997 Form 1040-ES in the mail. It will have payment-vouchers preprinted with your name, address, and social security number. Using the preprinted vouchers will speed processing, reduce the chance of error, and help save processing costs.

If you did not pay estimated tax last year, you will have to get a copy of Form 1040-ES from the IRS. Do so by calling 1-800-TAX-FORM (1-800-829-3676). After you make your first payment, a Form 1040-ES package with the preprinted vouchers will be mailed to you. Follow the instructions in the package to make sure you use the vouchers correctly.

Use the window envelopes that came with your Form 1040-ES package. If you use your own envelopes, make sure you mail your payment-vouchers to the address shown in the Form 1040-ES instructions for the place where you live. **Do not** use the address shown in the Form 1040 or Form 1040A instructions.

**Change of address.** You must notify the IRS if you are making estimated tax payments and you changed your address during the year. You must send a clear and concise written statement to the IRS Center where you filed your last return and provide all of the following:

- Your full name (and your spouse's full name),
- Your signature (and spouse's signature),
- Your old address (and spouse's old address if different),
- Your new address, and
- Your social security number (and spouse's social security number).

You can use **Form 8822, Change of Address**, for this purpose.

You can continue to use your old preprinted payment-vouchers until the IRS sends you new ones. However, **DO NOT** correct the address on the old voucher.

## Illustrated Examples

The following examples show how to figure estimated tax payments under the regular installment method and under the annualized income installment method.

### Example 2.9: Regular Installment Method

Early in 1997, Anne and Larry Jones figure their estimated tax payments for the year. They expect to receive the following income during 1997:

Larry's salary	\$29,200
Unemployment compensation	600
Anne's net profit from self-employment	38,500
Net rental income	2,671
Interest income	2,300
Dividends	3,745
<b>Total</b>	<b>\$77,016</b>

They also use the following expected items to figure their estimated tax:

Adjustment to income for IRA contributions	\$ 1,000
Itemized deductions	8,500
Deduction for exemptions (\$2,650 × 2)	5,300
1996 total tax	15,220
Withholding	5,800

The Joneses plan to file a joint return for 1997. They use the *1997 Estimated Tax Worksheet* included in Form 1040-ES to figure their estimated tax payments. Their filled-in worksheet follows this discussion.

**Expected adjusted gross income.** Anne can claim an income tax deduction for one-half of her self-employment tax as a business expense. So before the Joneses figure their expected adjusted gross income, they figure Anne's expected self-employment tax, as follows:

#### Filled-in Worksheet 2.2 for Anne Jones (Example 2.9)

- Enter your expected income and profits subject to self-employment tax ..... **\$ 38,500**
  - Multiply the amount on line 1 by .9235 ..... **\$ 35,555**
  - Multiply the amount on line 2 by .029 ..... **\$ 1,031**
  - Social security tax maximum income ..... **\$ 65,400**
  - Enter your expected wages (if subject to social security tax) ..... **-0-**
  - Subtract line 5 from line 4 ..... **\$ 65,400**
- Note.** If line 6 is zero or less, enter -0- on line 8 and skip to line 9.
- Enter the smaller of line 2 or line 6 ..... **\$ 35,555**

8.	Multiply the amount on line 7 by .124 .....	\$ 4,409
9.	Add line 3 and line 8. Enter the result here and on line 11 of your 1997 Estimated Tax Worksheet ...	\$ 5,440
10.	Multiply the amount on line 9 by .50. This is your deduction for one-half your self-employment tax .....	\$ 2,720

The Joneses enter \$35,555 on the dotted line and \$5,440 in the blank on line 11 of the worksheet. They subtract one-half of that amount, \$2,720, and their \$1,000 adjustment for IRA contributions from their \$77,016 total income to find their expected adjusted gross income, \$73,296. They enter that amount on line 1 of the worksheet.

**Expected taxable income.** The Joneses find their standard deduction, \$6,900, in the *1997 Standard Deduction Tables*. This is smaller than their expected itemized deductions, so they enter \$8,500 on line 2 of the worksheet. They subtract the amount on line 2 from the amount on line 1 and enter the result, \$64,796, on line 3. They enter their deduction for exemptions, \$5,300, on line 4. After subtracting these amounts, their expected taxable income on line 5 is \$59,496.

**Expected taxes and credits.** The Joneses use the 1997 Tax Rate Schedule Y-1 at the end of this chapter to figure their expected income tax, and enter \$11,303 on line 6 of the worksheet. They do not expect to owe any additional taxes that would be entered on lines 7 or 12, or have any credits that would be entered on lines 9 or 13b, so they leave those lines blank.

The Joneses' total expected tax on line 13c, after adding Anne's self-employment tax, is \$16,743.

**Estimated tax.** The Joneses multiply their total expected tax by 90% and enter \$15,069 on line 14a of the worksheet. They enter their 1996 tax on line 14b. Their required annual payment on line 14c is the smaller amount, \$15,069.

They enter Larry's expected withholding, \$5,800, on line 15 and subtract it from their required annual payment. Their estimated tax on line 16 is \$9,269.

**Required estimated tax payment.** The Joneses' first estimated tax payment is due April 15, 1997. They enter one-fourth of their estimated tax, \$2,317, on line 17 of the worksheet and on their Form 1040-ES payment-voucher due April 15. They mail the voucher with their payment to the address shown for their area in the Form 1040-ES instructions, and record the payment on the *Record of Estimated Tax Payments* in the instructions.

If their estimated tax does not change during the year, the Joneses also will pay \$2,317 estimated tax by June 16 and September 15, 1997, and January 15, 1998.

## Example 2.10: Annualized Income Installment Method

The facts are the same as in Example 2.9, except that the Joneses do not expect to receive their income evenly throughout the year. Anne expects to receive the largest portion of her self-employment income during the last few months of the year, and the Joneses' rental income is from a vacation home rented only in the summer months.

After completing their *1997 Estimated Tax Worksheet*, the Joneses decide to use the annualized income installment method to see if they can pay less than \$2,317 estimated tax for one or more payment periods. They complete the *1997 Annualized Estimated Tax Worksheet (Worksheet 2.10)* in this chapter. Their filled-in worksheet follows their filled-in *1997 Estimated Tax Worksheet* at the end of this discussion.

### First Period

On April 1, 1997, the Joneses complete the first column of the worksheet for the period January 1 through March 31. They had the following income for the period:

Larry's salary	\$ 6,900
Unemployment compensation	600
Anne's net profit from self-employment	3,000
Net rental income	—
Interest income	500
Dividends	462
<b>Total</b>	<b>\$11,462</b>

They also take into account the following items for the period:

Adjustment to income for IRA contributions	\$ 150
Itemized deductions	1,200
Withholding	1,350

**Annualized adjusted gross income.** Before the Joneses figure their adjusted gross income for the period, they first figure Anne's self-employment tax in Section B, and then her adjustment to income for self-employment tax.

On line 27a of Section B, they enter \$3,000, Anne's net profit from self-employment for the period. On line 27b, they enter \$2,771, which is line 27a multiplied by .9235. Anne's annualized net profit on line 27d of that worksheet is \$11,084. She has no social security wages, so they enter zero on lines 29 and 31. Then they enter \$65,400 on line 32. Because Anne's \$11,084 annualized self-employment income on line 27d is smaller than this amount, Anne's annualized social security tax on line 33 is \$1,374 ( $\$11,084 \times .124$ ). Her annualized Medicare tax on line 34 is \$321 ( $\$11,084 \times .029$ ), for a total annualized self-employment tax on line 35a of \$1,695. They enter that amount on line 13 of Section A.

The Joneses figure their adjustment to income for Anne's self-employment tax on lines 35b and 35c. They figure the amount to be \$212 ( $\$1,695 \div 8$ ). They subtract that amount and their \$150 IRA contributions from their \$11,462 total income and enter their adjusted

gross income for the period, \$11,100, on line 1 of Section A. They multiply that amount by 4 and enter their annualized adjusted gross income, \$44,400, on line 3.

**Annualized taxable income.** The Joneses figure their annualized itemized deductions ( $\$1,200 \times 4$ ) on lines 4 through 6 of Section A. Because the \$4,800 result is smaller than their standard deduction, they enter their \$6,900 standard deduction on line 8. After subtracting that amount and their \$5,300 deduction for exemptions, the Joneses' annualized taxable income on line 11 is \$32,200.

**Annualized taxes and credits.** The Joneses use the 1997 Tax Rate Schedule Y-1 at the end of this chapter to figure their annualized income tax, \$4,830, on line 12 of Section A.

The Joneses have no other taxes or credits for the period that would be entered on lines 14 or 16, so they leave those lines blank and enter \$6,525 ( $\$4,830 + \$1,695$ ) on lines 15 and 17. This is their annualized total tax.

**Required estimated tax payment.** The Joneses' annualized income installment on line 21 of Section A is \$1,468 ( $\$6,525 \times 22.5\%$ ). On lines 22 and 24 they enter \$3,767, one-fourth of their \$15,069 required annual payment under the regular installment method of figuring estimated tax payments (from line 14c of the *1997 Estimated Tax Worksheet*). Because \$1,468 is smaller, they enter the \$2,299 difference on line 25 and then enter \$1,468 on lines 26a and 26b.

Larry's total expected withholding for the year is \$5,800. The Joneses can treat one-fourth of that amount, \$1,450, as paid on April 15, or they can choose to use Larry's actual withholding for the period, \$1,350. Because they want to make their required estimated tax payment as small as possible, the Joneses enter \$1,450 on line 26c.

On line 26d, the Joneses' required estimated tax payment for the period under the annualized income installment method is \$18 ( $\$1,468 - \$1,450$ ). They enter that amount on their Form 1040-ES payment-voucher due April 15, 1997.

### Second, Third, and Fourth Periods

After the end of each remaining payment period, the Joneses complete the column of the worksheet for that period (from the beginning of the year through the end of that payment period) in the same way they did for the first period. They had the following income for each period:

	Second Jan. 1- May 31	Third Jan. 1- Aug. 31	Fourth Jan. 1- Dec. 31
Larry's salary	\$11,800	\$19,200	\$29,200
Unemployment compensation	600	600	600
Anne's net profit from self-employment	6,000	15,850	38,500
Net rental income	668	2,671	2,671

Interest income	850	1,450	2,300
Dividends	<u>674</u>	<u>1,708</u>	<u>3,745</u>
Total	\$20,592	\$41,479	\$77,016

They also take into account the following items for each period:

	Second Jan. 1- May 31	Third Jan. 1- Aug. 31	Fourth Jan. 1- Dec. 31
Adjustment to income for IRA contributions	\$ 250	\$ 400	\$ 1,000
Itemized deductions	2,700	6,400	8,500

For the second period, as for the first, the annualized income installment method allows the Joneses to pay less than their required payment under the regular installment method of figuring estimated tax payments. They

make up the difference in the third and fourth periods when their income is higher.

Because the Joneses are using the annualized income installment method, they will file Form 2210 with their tax return for 1997.

**1997 Estimated Tax Worksheet (keep for your records)**

1	Enter amount of adjusted gross income you expect in 1997 (see instructions) . . . . .	1	73,296
2	<ul style="list-style-type: none"> <li>• If you plan to itemize deductions, enter the estimated total of your itemized deductions. Caution: If line 1 above is over \$121,200 (\$60,600 if married filing separately), your deduction may be reduced. See Pub. 505 for details.</li> <li>• If you do not plan to itemize deductions, see <b>Standard Deduction for 1997</b> on page 2, and enter your standard deduction here.</li> </ul>	2	8,500
3	Subtract line 2 from line 1 . . . . .	3	64,796
4	Exemptions. Multiply \$2,650 by the number of personal exemptions. If you can be claimed as a dependent on another person's 1997 return, your personal exemption is not allowed. Caution: If line 1 above is over \$181,800 (\$151,500 if head of household; \$121,200 if single; \$90,900 if married filing separately), see Pub. 505 to figure the amount to enter . . . . .	4	5,300
5	Subtract line 4 from line 3 . . . . .	5	59,496
6	Tax. Figure your tax on the amount on line 5 by using the 1997 Tax Rate Schedules on page 2. DO NOT use the Tax Table or the Tax Rate Schedules in the 1996 Form 1040 or Form 1040A instructions. Caution: If you have a net capital gain and line 5 is over \$98,600 (\$85,350 if head of household; \$59,750 if single; \$49,800 if married filing separately), see Pub. 505 to figure the tax . . . . .	6	11,303
7	Additional taxes (see instructions) . . . . .	7	
8	Add lines 6 and 7 . . . . .	8	11,303
9	Credits (see instructions). Do not include any income tax withholding on this line . . . . .	9	
10	Subtract line 9 from line 8. Enter the result, but not less than zero . . . . .	10	11,303
11	Self-employment tax (see instructions). Estimate of 1997 net earnings from self-employment <u>\$35,555</u> ; if \$65,400 or less, multiply the amount by 15.3%; if more than \$65,400, multiply the amount by 2.9%, add \$8,109.60 to the result, and enter the total. Caution: If you also have wages subject to social security tax, see Pub. 505 to figure the amount to enter . . . . .	11	5,440
12	Other taxes (see instructions). . . . .	12	
13a	Add lines 10 through 12 . . . . .	13a	16,743
b	Earned income credit and credit from Form 4136 . . . . .	13b	
c	Subtract line 13b from line 13a. Enter the result, but not less than zero. <b>THIS IS YOUR TOTAL 1997 ESTIMATED TAX</b> . . . . . ▶	13c	16,743
14a	Multiply line 13c by 90% (66% for farmers and fishermen) . . . . .	14a	15,069
b	Enter the tax shown on your 1996 tax return (110% of that amount if you are not a farmer or a fisherman and the adjusted gross income shown on that return is more than \$150,000 or, if married filing separately for 1997, more than \$75,000) . . . . .	14b	15,220
c	Enter the smaller of line 14a or 14b. <b>THIS IS YOUR REQUIRED ANNUAL PAYMENT TO AVOID A PENALTY</b> . . . . . ▶ Caution: Generally, if you do not prepay (through income tax withholding and estimated tax payments) at least the amount on line 14c, you may owe a penalty for not paying enough estimated tax. To avoid a penalty, make sure your estimate on line 13c is as accurate as possible. Even if you pay the required annual payment, you may still owe tax when you file your return. If you prefer, you may pay the amount shown on line 13c. For more details, see Pub. 505.	14c	15,069
15	Income tax withheld and estimated to be withheld during 1997 (including income tax withholding on pensions, annuities, certain deferred income, etc.) . . . . .	15	5,800
16	Subtract line 15 from line 14c. (Note: If zero or less, or line 13c minus line 15 is less than \$500, stop here. You are not required to make estimated tax payments.) . . . . .	16	9,269
17	If the first payment you are required to make is due April 15, 1997, enter 1/4 of line 16 (minus any 1996 overpayment that you are applying to this installment) here and on your payment voucher(s)	17	2,317

**Filed-in 1997 Annualized Estimated Tax Worksheet for Example 2.10**

<b>Section A (For Figuring Your Annualized Estimated Tax Payments)</b> —Complete each column after end of period shown.					
<b>Estates and trusts:</b> Use the following ending dates in each column—2/28, 4/30, 7/31, 11/30.		<b>1/1/97 to 3/31/97</b>	<b>1/1/97 to 5/31/97</b>	<b>1/1/97 to 8/31/97</b>	<b>1/1/97 to 12/31/97</b>
<b>1</b> Adjusted gross income for the period. ( <b>Caution:</b> See instructions.) Self-employed: Complete Section B first.	<b>1</b>	11,100	19,918	39,959	73,296
<b>2</b> Annualization amounts. (Estates and trusts, <b>do not</b> use the amounts shown to right. Instead, use 6, 3, 1.71429, and 1.09091.)	<b>2</b>	4	2.4	1.5	1
<b>3</b> Multiply line 1 by line 2.	<b>3</b>	44,400	47,803	59,939	73,296
<b>4</b> Itemized deductions for period. If you do not expect to itemize, skip to line 6 and enter zero.	<b>4</b>	1,200	2,700	6,400	8,500
<b>5</b> Annualization amounts. (Estates and trusts, <b>do not</b> use the amounts shown to right. Instead, use 6, 3, 1.71429, and 1.09091.)	<b>5</b>	4	2.4	1.5	1
<b>6</b> Multiply line 4 by line 5. ( <b>Caution:</b> See instructions and Worksheet 2.7.)	<b>6</b>	4,800	6,480	9,600	8,500
<b>7</b> Standard deduction from 1997 tables.	<b>7</b>	6,900	6,900	6,900	6,900
<b>8</b> Enter the larger of line 6 or line 7.	<b>8</b>	6,900	6,900	9,600	8,500
<b>9</b> Subtract line 8 from line 3.	<b>9</b>	37,500	40,903	50,339	64,796
<b>10</b> Multiply \$2,650 by your total expected exemptions. ( <b>Caution:</b> See instructions and Worksheet 2.8.)	<b>10</b>	5,300	5,300	5,300	5,300
<b>11</b> Subtract line 10 from line 9.	<b>11</b>	32,200	35,603	45,039	59,496
<b>12</b> Tax on the amount on line 11 from the 1997 Tax Rate Schedules. ( <b>Caution:</b> See instructions and Worksheet 2.9.)	<b>12</b>	4,830	5,340	7,255	11,303
<b>13</b> Self-employment tax from line 35a of Section B.	<b>13</b>	1,695	2,035	3,360	5,440
<b>14</b> Other taxes for the period.	<b>14</b>				
<b>15</b> Add lines 12, 13, and 14.	<b>15</b>	6,525	7,375	10,615	16,743
<b>16</b> Credits for the period.	<b>16</b>				
<b>17</b> Total tax. Subtract line 16 from line 15. (If less than zero, enter zero.)	<b>17</b>	6,525	7,375	10,615	16,743
<b>18</b> Applicable percentage.	<b>18</b>	22.5%	45%	67.5%	90%
<b>19</b> Multiply line 17 by line 18.	<b>19</b>	1,468	3,319	7,165	15,069
<b>20</b> Add amounts on line 26a of all preceding columns.	<b>20</b>	//////////	1,468	3,319	7,165
<b>21</b> Annualized income installment. Subtract line 20 from line 19. (If less than zero, enter zero.)	<b>21</b>	1,468	1,851	3,846	7,904
<b>22</b> Divide line 14c of the Form 1040-ES Estimated Tax Worksheet by 4.	<b>22</b>	3,767	3,767	3,767	3,767
<b>23</b> Enter amount from line 25 of preceding column.	<b>23</b>	//////////	2,299	4,215	4,136
<b>24</b> Add lines 22 and 23.	<b>24</b>	3,767	6,066	7,982	7,903
<b>25</b> If line 24 is more than line 21, subtract line 21 from line 24. Otherwise, enter zero.	<b>25</b>	2,299	4,215	4,136	-0-
<b>26a</b> Enter the smaller of line 21 or line 24. ( <b>Caution:</b> See instructions.)	<b>26a</b>	1,468	1,851	3,846	7,903
<b>b</b> Total required payments for the period. Add lines 20 and 26a.	<b>26b</b>	1,468	3,319	7,165	15,068
<b>c</b> Estimated tax payments made (line 26d of all previous columns) and tax withholding through the due date for the period.	<b>26c</b>	1,450	2,918	4,769	8,615
<b>d</b> Estimated tax payment required by the next due date. Subtract line 26c from line 26b and enter the result (but not less than zero) here and on your payment-voucher.	<b>26d</b>	18	401	2,396	6,453

**Filed-in 1997 Annualized Estimated Tax Worksheet for Example 2.10 (continued)**

<b>Section B (For Figuring Your Annualized Estimated Self-Employment Tax)—Complete each column after end of period shown.</b>						
		<b>1/1/97 to 3/31/97</b>	<b>1/1/97 to 5/31/97</b>	<b>1/1/97 to 8/31/97</b>	<b>1/1/97 to 12/31/97</b>	
<b>27a</b>	Self-employment net profit for the period.	<b>27a</b>	3,000	6,000	15,850	38,500
<b>b</b>	Multiply line 27a by 92.35% and enter the result.	<b>27b</b>	2,771	5,541	14,637	35,555
<b>c</b>	Annualization amounts.	<b>27c</b>	4	2.4	1.5	1
<b>d</b>	Multiply line 27b by line 27c.	<b>27d</b>	11,084	13,298	21,956	35,555
<b>28</b>	Social security tax maximum income.	<b>28</b>	\$65,400	\$65,400	\$65,400	\$65,400
<b>29</b>	Social security wages and tips for the period.	<b>29</b>	-0-	-0-	-0-	-0-
<b>30</b>	Annualization amounts.	<b>30</b>	4	2.4	1.5	1
<b>31</b>	Multiply line 29 by line 30.	<b>31</b>	-0-	-0-	-0-	-0-
<b>32</b>	Subtract line 31 from line 28. If zero or less, enter -0-.	<b>32</b>	\$65,400	\$65,400	\$65,400	\$65,400
<b>33</b>	Multiply the smaller of line 27d or line 32 by .124.	<b>33</b>	1,374	1,649	2,723	4,409
<b>34</b>	Multiply line 27d by .029.	<b>34</b>	321	386	637	1,031
<b>35a</b>	Add lines 33 and 34. Enter the result here and on line 13 of Section A.	<b>35a</b>	1,695	2,035	3,360	5,440
<b>b</b>	Annualization amounts.	<b>35b</b>	8	4.8	3	2
<b>c</b>	Deduction for one-half of self-employment tax. Divide line 35a by 35b. Enter the result here. Also use this result to figure your adjusted gross income on line 1.	<b>35c</b>	212	424	1,120	2,720

# 1997 Standard Deduction Tables

**Caution.** If you are married filing a separate return and your spouse itemizes deductions, or if you are a dual-status alien, you cannot take the standard deduction even if you were 65 or older or blind.

**Table 1. Standard Deduction Chart for Most People\***

If Your Filing Status Is:	Your Standard Deduction Is:
Single	\$4,150
Married filing joint return or Qualifying widow(er) with dependent child—	6,900
Married filing separate return	3,450
Head of household	6,050

\* DO NOT use this chart if you are 65 or older or blind, OR if someone can claim you (or your spouse if married filing jointly) as a dependent.

**Table 2. Standard Deduction Chart for People Age 65 or Older or Blind\***

Check the correct number of boxes below. Then go to the chart.		
You	65 or older <input type="checkbox"/>	Blind <input type="checkbox"/>
Your spouse, if claiming spouse's exemption	65 or older <input type="checkbox"/>	Blind <input type="checkbox"/>
Total number of boxes you checked <input type="checkbox"/>		
If Your Filing Status is:	And the Number in the Box Above is:	Your Standard Deduction is:
Single	1	\$5,150
	2	6,150
Married filing joint return or Qualifying widow(er) with dependent child	1	7,700
	2	8,500
	3	9,300
	4	10,100
Married filing separate return	1	4,250
	2	5,050
	3	5,850
	4	6,650
Head of household	1	7,050
	2	8,050

\* If someone can claim you (or your spouse if married filing jointly) as a dependent, use Table 3, instead.

**Table 3. Standard Deduction Worksheet for Dependents\***

If you are 65 or older or blind, check the correct number of boxes below. Then go to the worksheet.	
You	65 or older <input type="checkbox"/> Blind <input type="checkbox"/>
Your spouse, if claiming spouse's exemption	65 or older <input type="checkbox"/> Blind <input type="checkbox"/>
Total number of boxes you checked <input type="checkbox"/>	
<b>1.</b> Enter your <b>earned income</b> (defined below). If none, go on to line 3	<b>1.</b> _____
<b>2.</b> Minimum amount	<b>2.</b> <u>\$650</u>
<b>3.</b> Compare the amounts on lines 1 and 2. Enter the <b>larger</b> of the two amounts here	<b>3.</b> _____
<b>4.</b> Enter on line 4 the amount shown below for your filing status. <ul style="list-style-type: none"> <li>• Single, enter \$4,150</li> <li>• Married filing separate return, enter \$3,450</li> <li>• Married filing jointly or Qualifying widow(er) with dependent child, enter \$6,900</li> <li>• Head of household, enter \$6,050</li> </ul>	<b>4.</b> _____
<b>5. Standard deduction.</b>	
<b>a.</b> Compare the amounts on lines 3 and 4. Enter the <b>smaller</b> of the two amounts here. If under 65 and not blind, stop here. This is your standard deduction. Otherwise, go on to line 5b	<b>5a.</b> _____
<b>b.</b> If 65 or older or blind, multiply \$1,000 (\$800 if married or qualifying widow(er) with dependent child) by the number in the box above. Enter the result	<b>5b.</b> _____
<b>c.</b> Add lines 5a and 5b. This is your standard deduction for 1997.	<b>5c.</b> _____
<b>Earned income</b> includes wages, salaries, tips, professional fees, and other compensation received for personal services you performed. It also includes any amount received as a scholarship that you must include in your income.	

\* Use this worksheet ONLY if someone can claim you (or your spouse if married filing jointly) as a dependent.

## 1997 Tax Rate Schedules

**Caution:** Do not use these Tax Rate Schedules to figure your 1996 taxes. Use only to figure your 1997 estimated taxes.

<b>Single—Schedule X</b>				<b>Head of household—Schedule Z</b>			
If line 5 is:		The tax is:	of the amount over—	If line 5 is:		The tax is:	of the amount over—
Over—	But not over—			Over—	But not over—		
\$0	\$24,650	.....15%	\$0	\$0	\$33,050	.....15%	\$0
24,650	59,750	\$3,897.50 + 28%	24,650	33,050	85,350	\$4,957.50 + 28%	33,050
59,750	124,650	13,525.50 + 31%	59,750	85,350	138,200	19,601.50 + 31%	85,350
124,650	271,050	33,644.50 + 36%	124,650	138,200	271,050	35,985.00 + 36%	138,200
271,050	.....	86,348.50 + 39.6%	271,050	271,050	.....	83,811.00 + 39.6%	271,050
<b>Married filing jointly or Qualifying widow(er)—Schedule Y-1</b>				<b>Married filing separately—Schedule Y-2</b>			
If line 5 is:		The tax is:	of the amount over—	If line 5 is:		The tax is:	of the amount over—
Over—	But not over—			Over—	But not over—		
\$0	\$41,200	.....15%	\$0	\$0	\$20,600	.....15%	\$0
41,200	99,600	\$6,180.00 + 28%	41,200	20,600	49,800	\$3,090.00 + 28%	20,600
99,600	151,750	22,532.00 + 31%	99,600	49,800	75,875	11,266.00 + 31%	49,800
151,750	271,050	38,698.50 + 36%	151,750	75,875	135,525	19,349.25 + 36%	75,875
271,050	.....	81,648.50 + 39.6%	271,050	135,525	.....	40,823.25 + 39.6%	135,525

## 3.

# Credit for Withholding and Estimated Tax for 1996

## Important Change for 1996

**Excess social security or railroad retirement tax withholding.** You will have excess social security or tier 1 railroad retirement tax withholding for 1996 only if your total wages from two or more employers were more than \$62,700.

## Introduction

When you file your 1996 income tax return, take credit for all the income tax and excess social security or railroad retirement tax withheld from your salary, wages, pensions, etc. Also, take credit for the estimated tax you paid for 1996. These credits are subtracted from your tax. You should file a return and claim these credits even if you do not owe tax.

If the total of your withholding and your estimated tax payments for any payment period is less than the amount you needed to pay by the due date for that period, you may be charged a penalty even if the total of these credits is more than your tax for the year.

### Topics

This chapter discusses:

- How to take credit for withholding
- How to take credit for estimated taxes you paid
- How to take credit for excess social security or railroad retirement tax withholding

## Withholding

If you had income tax withheld during 1996, you should receive a statement by January 31, 1997, showing your income and the tax withheld. Depending on the source of your income, you will receive:

- Form W-2, *Wage and Tax Statement*,
- Form W-2G, *Certain Gambling Winnings*, or
- A form in the 1099 series.

**Forms W-2 and W-2G.** You file Form W-2 with your income tax return. File Form W-2G with your return if it shows any federal income tax withheld from your winnings.

You should get at least two copies of each form you receive. Attach Copy B to the front of your federal income tax return. Copy C is for your records. You should also receive copies to file with your state and local returns.

## Form W-2

Your employer should give you a Form W-2 for 1996 by January 31, 1997. You should receive a separate Form W-2 from each employer you worked for.

If you stop working before the end of the year, your employer can give you your Form W-2 at any time after you leave your job. However, your employer must give it to you by January 31 of the following year (or the next day that is not a Saturday, Sunday, or holiday if January 31 is a Saturday, Sunday, or holiday). If you ask for the form, your employer must give it to you within 30 days after receiving your written request or within 30 days after your final wage payment, whichever is later.

If you have not received your Form W-2 by January 31, 1997, you should ask your employer for it. If you do not receive it by February 15, call the IRS telephone number for your area. The number is listed in the Form 1040, Form 1040A, and Form 1040EZ instructions. You will be asked to give your employer's name, address, and telephone number, and, if known, your employer's identification number. You will also be asked for your address, social security number, daytime telephone number, dates of employment, and your best estimate of your total wages and federal income tax withheld.

Form W-2 shows your total pay and other compensation and the income tax, social security tax, and Medicare tax that was withheld during the year. Take credit for the federal income tax withheld on:

- Line 52, if you file Form 1040,
- Line 29a, if you file Form 1040A, or
- Line 7, if you file Form 1040EZ.

Form W-2 is also used to report any taxable sick pay you received and any income tax withheld from your sick pay.

## Form W-2G

If you had gambling winnings, the payer may have withheld 28% as income tax. If tax was withheld, the payer will give you a Form W-2G showing the amount you won and the amount of tax withheld. Report the amounts you won on line 21 of Form 1040. Take credit for the tax withheld on line 52 of Form 1040. If you had gambling winnings, you must use Form 1040; you cannot use Form 1040A or Form 1040EZ.

Gambling losses can be deducted on Schedule A (Form 1040) as a miscellaneous itemized deduction. However, you cannot deduct more than the gambling winnings you report on line 21.

## The 1099 Series

Most forms in the 1099 series are not filed with your return. You should receive these forms by January 31, 1997. Keep these forms for your

records. There are several different forms in this series, including:

- Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions*,
- Form 1099-DIV, *Dividends and Distributions*,
- Form 1099-G, *Certain Government Payments*,
- Form 1099-INT, *Interest Income*,
- Form 1099-MISC, *Miscellaneous Income*,
- Form 1099-OID, *Original Issue Discount*,
- Form 1099-R, *Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*,
- Form SSA-1099, *Social Security Benefit Statement*, and
- Form RRB-1099, *Payments by the Railroad Retirement Board*.

For some types of income reported on forms in the 1099 series, you may not be able to use Form 1040A or Form 1040EZ. See the instructions to these forms for details.

**Form 1099-R.** Attach Form 1099-R to your return if federal income tax withholding is shown in box 4. Include the amount withheld in the total on line 52 of Form 1040, or on line 29a of Form 1040A. You cannot use Form 1040EZ if you received payments reported on Form 1099-R.

**Backup withholding.** If you were subject to backup withholding on income you received during 1996, include the amount withheld, as shown on your Form 1099, in the total on line 52 of Form 1040, or line 29a of Form 1040A.

## Form Not Correct

If you receive a form with incorrect information on it, you should ask the payer for a corrected form. Call the telephone number or write to the address given for the payer on the form. The corrected Form W-2G or Form 1099 you receive will be marked "CORRECTED." A special form, Form W-2c, *Statement of Corrected Wage and Tax Amounts*, is used to correct a Form W-2.

## Form Received After Filing

If you file your return and you later receive a form for income that you did not include on your return, you should report the income and take credit for any income tax withheld by filing Form 1040X, *Amended U.S. Individual Income Tax Return*.

## Separate Returns

If you are married but file a separate return, you can take credit only for the tax withheld from your own income. Do not include any amount withheld from your spouse's income. However, different rules may apply if you live in a community property state.

**Community property states.** Arizona, California, Idaho, Louisiana, Nevada, New Mexico,

Texas, Washington, and Wisconsin are community property states. If you live in a community property state and file a separate return, you and your spouse must each report half of all community income in addition to your own separate income. Each of you takes credit for half of all taxes withheld on the community income. If you were divorced during the year, each of you generally must report half the community income and can take credit for half the withholding on that community income for the period before the divorce.

For more information on these rules, and some exceptions, see Publication 555, *Community Property*.

## Fiscal Years

If you file your tax return on the basis of a fiscal year (a 12-month period ending on the last day of any month except December), you must follow special rules, described below, to determine your credit for federal income tax withholding.

**Normal withholding.** During your fiscal year, one calendar year will end and another will begin. You can claim credit on your tax return only for the tax withheld during the calendar year ending in your fiscal year. You cannot claim credit for any of the tax withheld during the calendar year beginning in your fiscal year. You will be able to claim credit for that withholding on your return for next year.

The Form W-2 or 1099-R you receive for the calendar year that ends during your fiscal year will show the tax withheld and the income you received during that calendar year. Although you take credit for all the withheld tax shown on the form, report only the part of the income shown on the form that you received during your fiscal year. Add to that the income you received during the rest of your fiscal year.

**Example 3.1.** Miles Hanson files his return for a fiscal year ending June 30. In January 1997, he received a Form W-2 that showed that his wages for 1996 were \$15,600 and that his income tax withheld was \$1,409.40. His records show that he had received \$7,500 of the wages by June 30, 1996, and \$8,100 from July 1 through December 31, 1996.

On his return for the fiscal year ending June 30, 1997, Miles will report the \$8,100 he was paid in July through December of 1996, plus whatever he was paid during the rest of the fiscal year—January 1, 1997, to June 30, 1997. However, he takes credit for all \$1,409.40 that was withheld during 1996. He takes credit for none of the income tax withheld during 1997. He cannot split the credit and claim a part of it in each fiscal year.

**Backup withholding.** If income tax has been withheld from your income under the backup withholding rule, take credit for it on your tax return for the fiscal year in which you received the payment.

**Example 3.2.** Edna Smith's records show that she received income in February 1997

from which \$50 was withheld under the backup withholding rule. On her tax return for the fiscal year ending June 30, 1997, Edna takes credit for withheld income tax of \$50.

## Estimated Tax

Take credit for all your estimated tax payments for 1996 on line 53 of Form 1040 or line 29b of Form 1040A. Include any overpayment from 1995 that you had credited to your 1996 estimated tax. You must use Form 1040 or Form 1040A if you paid estimated tax. You cannot use Form 1040EZ.

If you were a beneficiary of an estate or trust, include on line 53, Form 1040, any trust payments of estimated tax credited to you (from line 13a of Schedule K-1 (Form 1041), *Beneficiary's Share of Income, Deductions, Credits, Etc.*). On the dotted line next to line 36 of Schedule E write "ES payment claimed" and the amount. Do not include this amount in the total on line 36. The payment is treated as being made by you on January 15, 1997. You must use Form 1040 and Schedule E to report income from an estate or trust. You cannot use Form 1040A or Form 1040EZ.

**Name changed.** If you changed your name, and you made estimated tax payments using your old name, attach a brief statement to the front of your tax return indicating:

- 1) When you made the payments,
- 2) The amount of each payment,
- 3) Which IRS address you sent the payments to,
- 4) Your name when you made the payments, and
- 5) Your social security number.

The statement should cover payments you made jointly with your spouse as well as any you made separately.

## Separate Returns

If you and your spouse made separate estimated tax payments for 1996 and you file separate returns, you can take credit only for your own payments.

If you made joint estimated tax payments, you must decide how to divide the payments between your returns. One of you can claim all of the estimated tax paid and the other none, or you can divide it in any other way you agree on. If you cannot agree, you must divide the payments in proportion to each spouse's individual tax as shown on your separate returns for 1996.

**Example 3.3.** James and Evelyn Brown made joint estimated tax payments for 1996 totaling \$3,000. They file separate Forms 1040. James' tax is \$4,000 and Evelyn's is \$1,000. If they do not agree on how to divide the \$3,000, they must divide it proportionately between their returns. Because James' tax

(\$4,000) is four-fifths of the total tax (\$5,000) due for both of them, his share of the estimated tax is \$2,400 (four-fifths of \$3,000). The balance, \$600 (one-fifth of \$3,000), is Evelyn's share.

## Divorced Taxpayers

If you made joint estimated tax payments for 1996, and you were divorced during the year, either you or your former spouse can claim all of the joint payments, or you each can claim part of them. If you cannot agree on how to divide the payments, you must divide them in proportion to each spouse's individual tax as shown on your separate returns for 1996. See *Example 3.3*, earlier.

If you claim any of the joint payments on your tax return, enter your former spouse's social security number (SSN) in the space provided on the front of Form 1040 or Form 1040A. If you divorced and remarried in 1996, enter your present spouse's SSN in that space and write your former spouse's SSN, followed by "DIV," to the left of line 53, Form 1040, or line 29b, Form 1040A.

## Excess Social Security or Railroad Retirement Tax Withholding

Most employers must withhold social security tax from your wages. The federal government and state and local governments in some cases do not have to withhold social security tax from their employees' wages.

If you work for a railroad employer, that employer must withhold tier 1 railroad retirement (RRTA) tax and tier 2 RRTA tax.

**Two or more employers.** If you worked for two or more employers in 1996, too much social security tax or RRTA tax may have been withheld from your pay. You can claim the excess as a credit against your income tax when you file your return. *Table 3.1* shows the maximum amount that should have been withheld for any of these taxes for 1996. Figure your excess credit on the appropriate worksheet following the table. You must figure any credit for each tax separately.

If you worked for both a railroad employer and a nonrailroad employer, figure your credit on the *Worksheet for Railroad Employees*.

**Note:** If you are claiming excess social security or RRTA tax withholding, you cannot file Form 1040EZ. You must file Form 1040 or Form 1040A.

**Joint returns.** If you are filing a joint return, you cannot add any social security or RRTA tax withheld from your spouse's income to the amount withheld from your income. You must figure the credit separately for both you and your spouse to determine if either of you has excess withholding.

**Table 3.1**

Type of Tax	Maximum wages subject to tax	Tax rate	Maximum tax to be withheld
Social security	\$ 62,700	6.2%	\$3,887.40
<b>Railroad employees</b>			
Tier 1			
railroad retirement (RRTA)	\$ 62,700	6.2%	\$3,887.40
Tier 2 RRTA	\$ 46,500	4.9%	\$2,278.50

**Note.** All wages are subject to Medicare tax withholding.

**Employer's error.** If any one employer withheld too much social security or RRTA tax, you cannot claim the excess as a credit against your income tax. Your employer must adjust this for you.

## Worksheet for Nonrailroad Employees

If you did not work for a railroad during 1996, figure the credit on the following worksheet.



**Worksheet 3.1**

- Add all social security tax withheld (but not more than \$3,887.40 for each employer). This tax should be shown in box 4 of your Forms W-2. Enter the total here \_\_\_\_\_
- Enter any uncollected social security tax on tips or group-term life insurance included in the total on Form 1040, line 51 \_\_\_\_\_
- Add lines 1 and 2. If \$3,887.40 or less, stop here. You cannot claim the credit \_\_\_\_\_
- Social security tax limit \_\_\_\_\_ 3,887.40
- Credit. Subtract line 4 from line 3. (See *Where to claim excess credit*, next.) \_\_\_\_\_

**Where to claim excess credit.** If you file Form 1040A, include the credit in the total on line 29d. Write "Excess SST" and show the

amount of the credit in the space to the left of the line.

If you file Form 1040, enter the credit on line 56.

**Example 3.4.** In 1996, Tom Martin earned \$45,000 working for the Brown Shoe Company and \$35,000 working for Lafayette Leather Design. Brown Shoe Company withheld \$2,790 for social security tax. Lafayette Leather Design withheld \$2,170 for social security tax. Because he worked for two employers and earned more than \$62,700, he had too much social security tax withheld. Tom figures his credit of \$1,072.60 as follows:

**Filled-in Worksheet 3.1 for Tom Martin (Example 3.4)**

- Add all social security tax withheld (but not more than \$3,887.40 for each employer). This tax should be shown in box 4 of your Forms W-2. Enter the total here \_\_\_\_\_ \$4,960.00
- Enter any uncollected social security tax on tips or group-term life insurance included in the total on Form 1040, line 51 \_\_\_\_\_ 0
- Add lines 1 and 2. If \$3,887.40 or less, stop here. You cannot claim the credit \_\_\_\_\_ 4,960.00
- Social security tax limit \_\_\_\_\_ 3,887.40
- Credit. Subtract line 4 from line 3. \_\_\_\_\_ \$1,072.60

## Worksheet for Railroad Employees

If you worked for a railroad in 1996, figure your credit on the following worksheet.



**Worksheet 3.2**

- Add all social security and tier 1 RRTA tax withheld (but not more than \$3,887.40 for each employer). Box 4 of your Forms W-2 should show social security tax and box 14 should show tier 1 RRTA tax. Enter the total here \_\_\_\_\_
- Enter any uncollected social security and tier 1 RRTA tax on tips or group-term life insurance included in the total on Form 1040, line 51 \_\_\_\_\_

- Add lines 1 and 2. If \$3,887.40 or less, enter -0- on line 5 and go to line 6 \_\_\_\_\_
- Social security and tier 1 RRTA tax limit \_\_\_\_\_ 3,887.40
- Subtract line 4 from line 3. (If less than zero, enter zero.) \_\_\_\_\_
- Add all tier 2 RRTA tax withheld (but not more than \$2,278.50 for each employer). Box 14 of your Forms W-2 should show tier 2 RRTA tax. Enter the total here \_\_\_\_\_
- Enter any uncollected tier 2 RRTA tax on tips or group-term life insurance included in the total on Form 1040, line 51 \_\_\_\_\_
- Add lines 6 and 7. If \$2,278.50 or less, enter -0- on line 10 and go to line 11 \_\_\_\_\_
- Tier 2 RRTA tax limit \_\_\_\_\_ 2,278.50
- Subtract line 9 from line 8. (If less than zero, enter zero.) \_\_\_\_\_
- Credit. Add lines 5 and 10. (See *Where to claim excess SST and RRTA*, next.) \_\_\_\_\_

**Where to claim excess SST and RRTA.** If you file Form 1040A, include the credit in the total on line 29d. Write "Excess SST" and show the amount of the credit in the space to the left of the line.

If you file Form 1040, enter the credit on line 56.

# Underpayment Penalty for 1996

## Important Changes for 1996

**Penalty due to new law waived.** You will not have to pay a penalty for underpaying either of the first two installments of 1996 estimated tax if you underpaid because of provisions in the Small Business Job Protection Act of 1996. Provisions in that Act that could have caused your underpayment are:

- 1) Repeal of the \$5,000 death benefit exclusion for beneficiaries of employees who died after August 20, 1996,
- 2) Changes in the taxation of certain punitive damages and damages that are not for physical injuries or sickness,
- 3) A change in the taxation of annuities that started after November 18, 1996,
- 4) Denial of an exemption and the child and dependent care credit for any individual (except a child born in December 1996) whose taxpayer identification number is not included on your return,
- 5) Repeal of the diesel-powered highway vehicle credit for vehicles bought after August 20, 1996,
- 6) A rule that lets a parent choose to report a child's 1996 interest and dividend income on the parent's 1996 return only if that income was less than \$6,500 (increased from \$5,000 in 1995),
- 7) Clarification that distributions from a qualified state tuition program may be taxable to the extent they are more than the amount contributed to the program,
- 8) Clarification that newspaper distributors and certain fishing crew members are not employees and so must pay self-employment tax,
- 9) A new rule for S corporation stock inherited from an individual who died after August 20, 1996,
- 10) Changes to the income forecast method of depreciation, generally for property placed in service after September 13, 1995, and
- 11) Changes in rules for certain foreign trusts.

For more information about these provisions, see Publication 553, *Highlights of 1996 Tax Changes*.

**Penalty rate.** The penalty for underpayment of 1996 estimated tax is figured at an annual rate of 8% for the number of days the underpayment remained unpaid from April 16, 1996, through June 30, 1996. The rate is 9%

for the period from July 1, 1996, through April 15, 1997.

## Important Reminders

**Household employment taxes.** Any household employment taxes that you may have to pay are not included in figuring your underpayment penalty for 1996. Beginning in 1998, you must include these taxes when figuring the penalty.

**Exception to use of prior year's tax.** Certain taxpayers (other than farmers and fishermen) must use 110% of their 1995 tax to figure any 1996 underpayment penalty. See *Higher income taxpayers*, under *General Rule*, later.

## Introduction

If you did not pay enough tax either through withholding or by making estimated tax payments, you will have an underpayment of estimated tax and you may have to pay a penalty.

Having completed copies of your 1995 and 1996 federal income tax returns may help you through this chapter.

**No penalty.** Generally, you will *not* have to pay a penalty for 1996 if any of the following situations applies to you.

- The total of your withholding and estimated tax payments was at least as much as your 1995 tax, you are not subject to the special rule limiting the use of the prior year's tax, and you paid all required estimated tax payments on time.
- The tax balance on your return (minus household employment taxes) is no more than 10% of your total 1996 tax, and you paid all required estimated tax payments on time.
- Your total 1996 tax (defined later) minus your withholding is less than \$500.
- You did not owe tax for 1995.
- All of the tax balance on your return is caused by employment taxes for household workers.

Special rules apply if you are a farmer or fisherman.

**IRS can figure the penalty for you.** If you think you owe the penalty but you do not want to figure it yourself when you file your tax return, you may not have to. Generally, the IRS will figure the penalty for you and send you a bill. However, you must complete Form 2210 or Form 2210-F and attach it to your return if you check any of the boxes in Part I. See *Reasons for filing*, later.

## Topics

This chapter discusses:

- The general rule for the underpayment penalty
- Special rules for certain individuals

- Exceptions to the underpayment penalty
- How to figure your underpayment and the amount of your penalty on Form 2210
- How to ask IRS to waive the penalty

## Useful Items

You may want to see:

### Form (and Instructions)

- 2210** Underpayment of Estimated Tax by Individuals, Estates, and Trusts
- 2210-F** Underpayment of Estimated Tax by Farmers and Fishermen

See Chapter 5 for information about getting these forms.

## General Rule

In general, you may owe a penalty for 1996 if the total of your withholding and estimated tax payments did not equal at least the **smaller of**:

- 1) 90% of your 1996 tax, or
- 2) 100% of your 1995 tax. (Your 1995 tax return must cover a 12-month period.)

Your 1996 tax, for this purpose, is your *Total tax for 1996*, defined later under *Exceptions*.

**Special rules for certain individuals.** There are special rules for farmers and fishermen and for certain higher income taxpayers.

**Farmers and fishermen.** If at least two-thirds of your gross income for 1995 or 1996 is from farming or fishing, substitute 66  $\frac{2}{3}$ % for 90% in (1) above.

See *Farmers and Fishermen* later.

**Higher income taxpayers.** If less than two-thirds of your gross income for 1995 and 1996 is from farming or fishing and your adjusted gross income (AGI) for 1995 was more than \$150,000 (\$75,000 if your filing status is married filing a separate return in 1996), substitute 110% for 100% in (2) above.

For 1995, AGI is the amount shown on Form 1040 – line 31; Form 1040A – line 16; and Form 1040EZ – line 4.

**Penalty figured for each period.** Because the penalty is figured separately for each payment period, you may owe a penalty for an earlier payment period even if you later paid enough to make up the underpayment. If you did not pay enough tax by the due date of each of the payment periods, you may owe a penalty even if you are due a refund when you file your income tax return.

**Example 4.1.** You did not make estimated tax payments during 1996 because you thought you had enough tax withheld from your wages. Early in January 1997, you made an estimate of your total 1996 tax. Then you realized that your withholding was \$2,000 less than the amount needed to avoid a penalty for underpayment of estimated tax.

On January 10, you made an estimated tax payment of \$3,000, the difference between

your withholding and your estimate of your total tax. Your final return shows your total tax to be \$50 less than your estimate, so you are due a refund.

You do not owe a penalty for your payment due January 15, 1997. However, you will owe a penalty through January 10 for your underpayments for the earlier payment periods.

**Minimum required each period.** You will owe a penalty for any 1996 payment period for which your estimated tax payment plus your withholding for the period and overpayments for previous periods was less than the *smaller* of:

- 1) 22.5% of your 1996 tax, or
- 2) 25% of your 1995 tax. (Your 1995 tax return must cover a 12-month period.)

**Note.** If you are subject to the rule for higher income taxpayers, discussed earlier, substitute 27.5% for 25% in (2) above.

**When penalty is charged.** If you miss a payment or you paid less than the minimum required in a period, you may be charged an underpayment penalty from the date the amount was due to the date the payment is made.

**Trust payments of estimated tax credited to you.** If you were a beneficiary of an estate or trust that credited its estimated tax payments to you, treat the amount credited (line 13a of Schedule K-1 (Form 1041), *Beneficiary's Share of Income, Deductions, Credits, Etc.*) as an estimated tax payment made by you on January 15, 1997.

**Amended returns.** If you file an amended return by the due date of your original return, use the tax shown on your amended return to figure your required estimated tax payments. If you file an amended return after the due date of the original return, use the tax shown on the original return.

However, if you and your spouse file a joint return after the due date to replace separate returns you originally filed by the due date, use the tax shown on the joint return to figure your required estimated tax payments. This rule applies only if both original separate returns were filed on time.

**1995 separate returns and 1996 joint return.** If you file a joint return with your spouse for 1996, but you filed separate returns for 1995, your 1995 tax is the total of the tax shown on your separate returns. You filed a separate return for 1995 if you filed as single, head of household, or married filing separately.

**1995 joint return and 1996 separate returns.** If you file a separate return for 1996, but you filed a joint return with your spouse for 1995, your 1995 tax is your share of the tax on the joint return. You filed a separate return for 1996 if you filed as single, head of household, or married filing separately. To figure your share, first figure the tax both you and your

spouse would have paid had you filed separate returns for 1995 using the same filing status as for 1996. Then multiply your joint tax liability by the following fraction:

$$\frac{\text{Your separate tax liability}}{\text{Both spouses' separate tax liabilities}}$$

**Example 4.2.** Lisa and Paul filed a joint return for 1995 showing taxable income of \$48,000 and a tax of \$8,377. Of the \$48,000 taxable income, \$40,000 was Lisa's and the rest was Paul's. For 1996, they file married filing separately. Lisa figures her share of the tax on the 1995 joint return as follows:

Tax on \$40,000 based on a separate return .....	\$ 8,672
Tax on \$8,000 based on a separate return .....	1,204
Total .....	\$ 9,876
Lisa's portion of total (\$8,672 ÷ \$9,876) .....	88%
Lisa's share of 1995 joint return tax (\$8,377 × 88%) .....	<u>\$ 7,372</u>

**Form 2210.** In most cases, you do not need to file Form 2210. The IRS will figure the penalty for you and send you a bill. If you want to figure your penalty, complete Part I, Part II, and either Part III or Part IV of Form 2210. **Do not** file Form 2210 unless you must file it, as explained later under *Reasons for filing*. If you use Form 2210, you cannot file Form 1040EZ.

On Form 1040, enter the amount of your penalty on line 63. If you owe tax on line 62, add the penalty to your tax due and show your total payment on line 62. If you are due a refund, subtract the penalty from the overpayment you show on line 59.

On Form 1040A, enter the amount of your penalty on line 34. If you owe tax on line 33, add the penalty to your tax due and show your total payment on line 33. If you are due a refund, subtract the penalty from the overpayment you show on line 30.

**Reasons for filing.** You may be able to lower or eliminate your penalty if you file Form 2210. You **must** file Form 2210 with your return if any of the following applies.

- 1) You request a waiver. (See *Waiver of Penalty*, later.)
- 2) You use the annualized income installment method. (See the explanation of this method under *Figuring Your Underpayment*, later.)
- 3) You use your actual withholding for each payment period for estimated tax purposes. (See *Actual withholding method* under *Figuring Your Underpayment*, later.)
- 4) You base any of your required installments on the tax shown on your 1995 return and you filed or are filing a joint return for either 1995 or 1996 but not for both years.

## Exceptions

Generally, you do not have to pay an underpayment penalty if either of the following conditions apply:

- Your total tax is less than \$500, or
- You had no tax liability last year.

## Less Than \$500 Due

You do not owe a penalty if the **total tax** shown on your return minus the amount you **paid through withholding** (including excess social security and railroad retirement tax withholding) is less than \$500.

**Total tax for 1996.** For 1996, your total tax on Form 1040 is the amount on line 51 reduced by the total of the following amounts:

- 1) Any recapture of a federal mortgage subsidy from Form 8828 included on line 51,
- 2) Any social security or Medicare tax on tips not reported to your employer on line 47,
- 3) Any tax on an IRA or a qualified retirement plan from Form 5329 (other than the tax on early distributions) included on line 48,
- 4) Any household employment taxes from Schedule H included on line 50,
- 5) Any uncollected social security, Medicare, or railroad retirement tax included on line 51,
- 6) Any earned income credit on line 54, and
- 7) Any credit for federal tax on fuels from Form 4136 included on line 57.

Your total tax on Form 1040A is the amount on line 28 minus the amount on lines 27 and 29c. Your total tax on Form 1040EZ is the amount on line 10 minus the amount on line 8.

**Paid through withholding.** For 1996, the amount you paid through withholding on Form 1040 is the amount on line 52 plus any excess social security or railroad retirement tax withholding on line 56. On Form 1040A, the amount you paid through withholding is the amount on line 29a, plus any excess social security or railroad retirement tax withholding included in the total on line 29d. On Form 1040EZ, it is the amount on line 7.

## No Tax Liability Last Year

You do not owe a penalty if you had no tax liability last year and you were a U.S. citizen or resident for the whole year. For this rule to apply, your tax year must have included all 12 months of the year.

You had no tax liability for 1995 if your total tax was zero or you did not need to file an income tax return.

**Example 4.3.** Ray, who is single and 22 years old, was unemployed for most of 1995. He earned \$2,700 in wages before he was laid off, and he received \$2,500 in unemployment

compensation afterwards. He had no other income. Even though he had gross income of \$5,200, he did not have to pay income tax because his gross income was less than the filing requirement for a single person under age 65 (\$6,400 for 1995). He filed a return only to have his withheld income tax refunded to him.

In 1996, Ray began regular work as an independent contractor. Ray made no estimated tax payments in 1996. Even though he did owe tax at the end of the year, Ray does not owe the underpayment penalty for 1996 because he had no tax liability in 1995.

**Total tax for 1995.** If you filed Form 1040 for 1995, your total tax is the amount on line 54 reduced by the total of the following amounts:

- 1) Any recapture of a federal mortgage subsidy from Form 8828 included on line 49,
- 2) Any social security or Medicare tax on tips not reported to your employer on line 50,
- 3) Any tax on an IRA or a qualified retirement plan from Form 5329 (other than the tax on early distributions) included on line 51,
- 4) Any uncollected social security, Medicare, or railroad retirement tax included on line 54,
- 5) Any earned income credit on line 57, and
- 6) Any credit for federal tax on fuels from Form 4136 included on line 60.

Your total tax on Form 1040A for 1995 is the amount on line 28 minus the amount on line 29c. Your total tax on Form 1040EZ for 1995 is the amount on line 10 minus the amount on line 8.

## Figuring Your Required Annual Payment

Figure your required annual payment in Part II of Form 2210, following the line-by-line instructions. If you rounded off the money items on your return to whole dollars, you can round off on Form 2210.

**Example 4.4.** The tax on Ivy Fields' 1995 return was \$10,000 (her AGI was not more than \$150,000). The tax on her 1996 return (Form 1040, line 38) is \$11,000. She does not claim any credits or pay any other taxes.

Ivy had \$1,600 income tax withheld and paid \$6,800 estimated tax for 1996. Her total payments were \$8,400. 90% of her 1996 tax is \$9,900. Because she paid less than either her 1995 tax or 90% of her 1996 tax, and does not meet an exception, Ivy knows that she owes a penalty for underpayment of estimated tax. She decides to figure the penalty on Form 2210 and pay it with her \$2,600 tax balance when she files her tax return.

Ivy's required annual payment (Part II, line 13) is \$9,900 ( $\$11,000 \times 90\%$ ) because that is smaller than her 1995 tax.

Ivy's filled-in Form 2210 is shown at the end of this chapter.

**Different 1995 filing status.** If you file a separate return for 1996, but you filed a joint return with your spouse for 1995, see *1995 joint return and 1996 separate returns*, earlier, to figure the amount to enter as your 1995 tax on line 12 of Form 2210.

## Short Method for Figuring the Penalty

You may be able to use the short method in Part III of Form 2210 to figure your penalty for underpayment of estimated tax. If you qualify to use this method, it will result in the same penalty amount as the regular method, but with fewer computations. However, either annualization or the actual withholding method, explained later, may result in a lower penalty.

You can use the short method **only** if you meet one of the following requirements.

- 1) You made no estimated tax payments for 1996 (it does not matter whether you had income tax withholding).
- 2) You paid estimated tax on all four due dates in equal installments. You must have paid the same amount on each of the following dates:
  - April 15, 1996,
  - June 17, 1996,
  - September 16, 1996, and
  - January 15, 1997.

If you do not meet either requirement, figure your penalty using the regular method in Part IV, Form 2210.

You **cannot** use the short method if any of the following applies:

- 1) You made any estimated tax payments late,
- 2) You checked the box on line 1b or 1c in Part I of Form 2210, or
- 3) You are filing Form 1040NR or 1040NR-EZ and you did not receive wages as an employee subject to U.S. income tax withholding.

**Note.** If you use the short method, you cannot use the annualized income installment method to figure your underpayment for each payment period. Also, you cannot use your actual withholding during each period to figure your payments for each period. These methods, which may give you a smaller penalty amount, are explained later under *Figuring Your Underpayment*.

**Completing Part III.** Complete Part III following the line-by-line instructions.

First, figure your total underpayment for the year (line 17) by subtracting the total of your withholding and estimated tax payments (line 16) from your required annual payment (Part II, line 13). Then figure the penalty you would owe if the underpayment remained unpaid up to April 15, 1997. This amount (line

18) is the maximum estimated tax penalty on your underpayment.

Next, figure any part of the maximum penalty you do not owe (line 19) because your underpayment was paid before the due date of your return. For example, if you filed your 1996 return and paid the tax balance on April 3, 1997, you do not owe the penalty for the 12-day period from April 4 through April 15. Therefore, you would figure the amount to enter on line 19 using 12 days.

Finally, subtract from the maximum penalty amount (line 18) any part you do not owe (line 19). The result (line 20) is the penalty you owe. Enter that amount on line 63 of Form 1040 or line 34 of Form 1040A. Attach Form 2210 to your return only if you checked one of the boxes in Part I.

**Example 4.5.** The facts are the same as in *Example 4.4*. Ivy paid her estimated tax payments in four installments of \$1,700 ( $\$6,800 \div 4$ ) each on the dates they were due.

Ivy qualifies to use the short method to figure her estimated tax penalty. Using the annualized income installment method or actual withholding will not give her a smaller penalty amount because her income and withholding were distributed evenly throughout the year. Therefore, she figures her penalty in Part III of Form 2210 and leaves Part IV (not shown) blank.

Ivy figures her \$1,500 total underpayment for the year (line 17) by subtracting the total of her withholding and estimated tax payments (\$8,400) from her \$9,900 required annual payment (Part II, line 13). The maximum penalty on her underpayment (line 18) is \$89 ( $\$1,500 \times .05914$ ).

Ivy plans to file her return and pay her \$2,600 tax balance on March 15, 1997, 31 days before April 15. Therefore, she does not owe part of the maximum penalty amount. The part she does not owe (line 19) is figured as follows.

$$\$1,500 \times 31 \times .00025 = \$12$$

Ivy subtracts the \$12 from the \$89 maximum penalty and enters the result, \$77, on line 20 and on line 63 of her Form 1040. She adds \$77 to her \$2,600 tax balance and enters the result, \$2,677, on line 62 of her Form 1040. Ivy files her return on March 15 and attaches a check for \$2,677. Because Ivy did not check any of the boxes in Part I, she does not attach Form 2210 to her tax return.

Ivy's filled-in Form 2210 is shown at the end of this chapter.

## Regular Method for Figuring the Penalty

You **must** use the regular method in Part IV of Form 2210 to figure your penalty for underpayment of estimated tax if any of the following apply to you.

- 1) You paid one or more estimated tax payments on a date other than the due date.
- 2) You paid at least one, but less than four, installments of estimated tax.

- 3) You paid estimated tax payments in unequal amounts.
- 4) You use the annualized income installment method to figure your underpayment for each payment period.
- 5) You use your actual withholding during each payment period to figure your payments.

If you use the regular method, figure your underpayment for each payment period in Section A, then figure your penalty for each payment period in Section B.

## Figuring Your Underpayment (Section A of Part IV)

Figure your underpayment of estimated tax for each payment period in Section A following the line-by-line instructions. Complete each line for a payment period column before completing the next column.

**Required installment.** Your required payment for each payment period (line 21) is usually one-fourth of your required annual payment (Part II, line 13). However, if you are using the annualized income installment method (described later), first complete Schedule AI (Form 2210), and then enter the amounts from line 26 of that schedule on line 21 of Form 2210.

**Payments.** On line 22, enter in each column the total of:

- 1) Your estimated tax paid after the due date for the previous column and by the due date shown, and
- 2) One-fourth of your withholding.

For special rules for figuring your payments, see the instructions for Form 2210.

If you file Form 1040, your withholding is the amount on line 52, plus any excess social security or railroad retirement tax withholding on line 56. If you file Form 1040A, your withholding is the amount on line 29a, plus any excess social security or railroad retirement tax withholding included in the total on line 29d.

**Actual withholding method.** Instead of using one-fourth of your withholding to figure your payments, you can choose to establish how much was actually withheld by the due dates and use those amounts. You can make this choice separately for the tax withheld from your wages and for all other withholding.

Using your actual withholding may result in a smaller penalty if most of your withholding occurred early in the year.

**Note.** If you use your actual withholding, you must check the box on line 1c, Part I of the Form 2210 and complete Form 2210 and file it with your return.

## Regular Installment Method

The filled-in form for the following example is shown at the end of this chapter.

**Example 4.6.** Ben Brown's 1996 tax (Form 1040, line 51) is \$7,031, the total of his \$4,685 income tax and \$2,346 self-employment tax. (His 1995 AGI was not more than \$150,000.) He does not owe any other taxes or claim any credits other than for withholding. His 1995 tax was \$6,116.

Ben's employer withheld \$3,228 income tax during 1996. Ben made no estimated tax payment for either the first or second period, but he paid \$1,000 each on August 30, 1996, and January 10, 1997, for the third and fourth periods. Because the total of his withholding and estimated tax payments, \$5,228 (\$3,228 + \$1,000 + \$1,000), was less than 90% of his 1996 tax (\$7,031), and was also less than his 1995 tax (\$6,116), Ben knows he owes a penalty for underpayment of estimated tax. He decides to figure the penalty on Form 2210 and pay it with his \$1,803 tax balance (\$7,031 - \$5,228) when he files his tax return on April 15, 1997.

Ben's required annual payment (Part II, line 13) is \$6,116. Because his income and withholding were distributed evenly throughout the year, Ben enters one-fourth of his required annual payment, \$1,529, on line 21. On line 22, he enters one-fourth of his withholding, \$807, plus his estimated tax payments.

Ben has an underpayment (line 28) for each payment period even though his withholding and estimated tax payments for the third and fourth periods were more than his required installments (line 21). This is because the estimated tax payments made in the third and fourth periods are first applied to underpayments for the earlier periods. *Example 4.8* illustrates completion of Part IV, Section B, of Ben's Form 2210.

## Annualized Income Installment Method (Schedule AI)

If you did not receive your income evenly throughout the year (for example, your income from a repair shop you operated was much larger in the summer than it was during the rest of the year), you may be able to lower or eliminate your penalty by figuring your underpayment using the **annualized income installment method**. Under this method, your required installment (line 21) for one or more payment periods may be less than one-fourth of your required annual payment.

To figure your underpayment using this method, complete Schedule AI of Form 2210. The schedule annualizes your tax at the end of each payment period based on your income, deductions, and other items relating to events that occurred since the beginning of the tax year through the end of the period.

**Note.** If you use the annualized income installment method, you must check the box on line 1b of Form 2210. You also must attach Form 2210 and Schedule AI to your return.

**Completing Schedule AI of Form 2210.** Follow your Form 2210 instructions to complete

Schedule AI. For each period shown on Schedule AI, figure your income and deductions based on your method of accounting. If you use the cash method of accounting (used by most people), include all income actually or constructively received during the period and all deductions actually paid during the period.

**Caution:** Each period includes amounts from the previous period(s).

- 1) **Period (a)** includes items for January through March,
- 2) **Period (b)** includes items for January through May,
- 3) **Period (c)** includes items for January through August, and
- 4) **Period (d)** includes items for the entire year.

**Example 4.7.** The facts are the same as in *Example 4.6*, except that Ben did not receive his income evenly throughout the year. Therefore, he decides to figure his required installment for each period (line 21 of Form 2210) using the annualized income installment method.

Ben's filled-in Schedule AI and Part IV of Form 2210 using this method are shown at the end of this chapter.

Ben's wages during 1996 were \$21,000 (\$1,750 a month). His net earnings from a business he started during the year were \$16,600, received as follows:

April through May	\$4,600
June through August	4,000
September through December	8,000

Before Ben can figure his adjusted gross income for each period (line 1 of Schedule AI), he must figure his deduction for self-employment tax for each period. He completes Part II of Schedule AI first.

Ben had no self-employment income for the first period, so he leaves the lines in that column blank. His self-employment income was \$4,600 for the second period, \$8,600 (\$4,600 + \$4,000) for the third period, and \$16,600 (\$8,600 + \$8,000) for the fourth period. He multiplies each amount by 92.35% (.9235) to find the amounts to enter on line 27a. He then fills out the rest of Part II.

Ben figures the amounts to enter on line 1 of Schedule AI as follows:

<b>1st Column</b> —1/1/96 to 3/31/96:	
\$1,750 per month × 3 months	\$ 5,250
<b>2nd Column</b> —1/1/96 to 5/31/96:	
\$1,750 per month × 5 months	\$ 8,750
Plus: Self-employment income through 5/31/96	4,600
Minus: Self-employment tax deduction (\$1,560 ÷ 4.8)	(325)
	<u>\$ 13,025</u>
<b>3rd Column</b> —1/1/96 to 8/31/96:	
\$1,750 per month × 8 months	\$ 14,000
Plus: Self-employment income through 8/31/96	8,600
Minus: Self-employment tax deduction (\$1,822 ÷ 3)	(607)
	<u>\$ 21,993</u>

**4th Column**—1/1/96 to 12/31/96:

\$1,750 per month × 12 months .....	\$ 21,000
Plus: Self-employment income through 12/31/96 .....	16,600
Minus: Self-employment tax deduction (\$2,346 ÷ 2) .....	(1,173)
	<u>\$ 36,427</u>

Ben's itemized deductions were \$6,000 and were spread evenly throughout the year. He is single, claims no dependents, and uses the 1996 Tax Table to figure the tax on his annualized income.

Ben overpaid his estimated tax for the first payment period, but he underpaid his estimated tax for the other three periods. *Example 4.9* illustrates how Ben completes Part IV, Section B, of his Form 2210.

## Figuring Your Penalty (Section B of Part IV)

Figure the amount of your penalty in Section B, Part IV of Form 2210, following the instructions. The penalty is imposed on each underpayment shown on line 28, Section A, for the number of days through April 15, 1997, that it remained unpaid. (You may find it helpful to show the date of payment beside each amount on line 28.)

Two penalty rates apply to 1996 underpayments. The rate is 8% for the period from April 16, 1996, through June 30, 1996. The rate is 9% for the period from July 1, 1996, through April 15, 1997.

**Note.** Even though only two penalty rates apply to 1996 underpayments, Part IV of Form 2210 has three rate periods. A separate rate period is needed from January 1, 1997, through April 15, 1997, because 1996 was a leap year.

**8% rate period.** To figure the number of days the 8% rate applies (line 30), count from the day after the payment due date shown in each column above line 30 through the earlier of:

- 1) The day the underpayment was paid, or
- 2) June 30, 1996.

Or you can use *Table 4-1*.

**9% rate period.** To figure the number of days the 9% rate applies (line 32), count from the day after the payment due date shown in each column above line 32 through the earlier of:

- 1) The day the underpayment was paid, or
- 2) December 31, 1996.

Or you can use *Table 4-1*.

**Second 9% rate period.** To figure the number of days the second 9% rate applies (line 34), count from the day after the payment due date shown in each column above line 34 through the earlier of:

- 1) The day the underpayment was paid, or
- 2) April 15, 1997.

Or you can use *Table 4-1*.

**Aid for counting days.** *Table 4-1* provides a simple method to count the number of days between payment dates or between a due date and a payment date.

- 1) Find the number for the date the payment was due.
- 2) Find the number for the date the payment was made.
- 3) Subtract the due date "number" from the payment date "number."

For example, if a payment was due on June 15 (61), but was not paid until November 4 (203), the payment was 142 (203 - 61) days late.

**Payments.** Before completing Section B, make a list of the payments you made after the due date (or the last day payments could be made on time) for the earliest payment period an underpayment occurred. For example, if you had an underpayment for the first payment period, list your payments after April 15, 1996. You can use the tables in the Form 2210 instructions to make your list. Follow those instructions for listing income tax withheld and payments made with your return. Use the list to determine when each underpayment was paid.

**Underpayment paid in two or more parts.** If an underpayment was paid in two or more parts on different dates, you must figure the penalty separately for each part. (You may find it helpful to show the underpayment on line 28, Section A, broken down into the parts paid on different dates.)

**Figuring the penalty.** Form 2210 for 1996 has 3 rate periods. Figure the underpayment penalty by applying the appropriate rate against each underpayment shown on line 28. If an underpayment remained unpaid for more than one rate period, the penalty on that underpayment will be figured using more than one rate.

Use lines 30, 32, and 34 to figure the number of days the underpayment remained unpaid. (Also see *Table 4-1*.) Use lines 31, 33, and 35 to figure the actual penalty amount by applying the rate against the underpayment for the number of days it remained unpaid.

If an underpayment remained unpaid for the entire period, use *Table 4-2* to determine the number of days to enter in each column of line 30, 32, or 34.

**Table 4-2**  
Chart of Total Days

	Column (a)	Column (b)	Column (c)	Column (d)
line 30	76	15	n/a	n/a
line 32	184	184	107	n/a
line 34	105	105	105	90

**Example 4.8.** In *Example 4.6*, Ben Brown determined that he had an underpayment for all four payment periods.

Ben's filled-in Form 2210 is shown at the end of this chapter. This example illustrates Part IV, Section B, of that form.

Ben's 1996 tax is \$7,031. His minimum required payment for each period is \$1,529 (\$6,116 ÷ 4). His \$3,228 withholding is considered paid in four equal installments of \$807, one on each payment due date. Therefore, he must make estimated tax payments of \$722 each period. Ben made estimated tax payments of \$1,000 on August 30, 1996, and \$1,000 on January 10, 1997. He plans to file his return and pay his \$1,803 tax balance (\$7,031 tax - \$5,228 withholding and estimated tax payments) on April 15, 1997. Therefore, he is considered to have made the following payments for tax year 1996:

April 15, 1996	\$ 807
June 15, 1996	807
August 30, 1996	1,000
September 15, 1996	807
January 10, 1997	1,000
January 15, 1997	807
April 15, 1997	1,803

**Penalty for first period (April 15, 1996) — column (a).** Ben's \$722 underpayment for the first payment period was paid by applying \$722 of his \$807 payment on June 15, 1996. The \$722 remained unpaid 61 days (April 16 through June 15, 1996). Ben enters "61" on line 30 and figures his penalty on line 31.

**Penalty for second period (June 15, 1996) — column (b).** Ben figures his second period underpayment as follows:

- 1) Of the \$807 he paid for the second period, \$722 is applied to the underpayment remaining from the first period.
- 2) That leaves \$85 (\$807 - \$722) to apply to his second period required installment of \$1,529.
- 3) The result, \$1,444 (\$1,529 - \$85) is Ben's underpayment for the second period.

The \$1,444 underpayment is paid in two parts by applying the \$1,000 paid on August 30 and \$444 of his \$807 September 15 payment. To help him figure his penalty, Ben shows each part of the underpayment paid on different dates on line 28.

Ben must figure the penalty using Rate Period 1 and Rate Period 2 as shown on Page 2 of Form 2210.

For **Rate Period 1**, the entire \$1,444 underpayment remained unpaid 15 days (June 16 through June 30, 1996). Ben enters "15" on line 30 and figures the penalty on line 31.

For **Rate Period 2**, \$1,000 of the underpayment remained unpaid 61 days (July 1 through August 30, 1996) and \$444 remained unpaid 77 days (July 1 through September 15, 1996). Ben enters those numbers on line 32 and figures his penalty for each part of the underpayment on line 33. He enters both penalty amounts on line 33.

**Penalty for third period (September 15, 1996) — column (c).** Ben figures his third period underpayment as follows:

**Table 4-1. Calendar to Determine Number of Days a Payment is Late**

**Instructions.** First, find the number for the payment due date. Then, find the number for the date the payment was made. Finally, subtract the payment due date number from the payment date number. The answer is the number of days the payment is late.  
**Example.** The payment due date is June 15 (61). The payment was made on November 4 (203). The payment is 142 days late (203 – 61).

Tax Year 1996													
Day of Month	1996 April	1996 May	1996 June	1996 July	1996 Aug.	1996 Sept.	1996 Oct.	1996 Nov.	1996 Dec.	1997 Jan.	1997 Feb.	1997 March	1997 April
1		16	47	77	108	139	169	200	230	261	292	320	351
2		17	48	78	109	140	170	201	231	262	293	321	352
3		18	49	79	110	141	171	202	232	263	294	322	353
4		19	50	80	111	142	172	203	233	264	295	323	354
5		20	51	81	112	143	173	204	234	265	296	324	355
6		21	52	82	113	144	174	205	235	266	297	325	356
7		22	53	83	114	145	175	206	236	267	298	326	357
8		23	54	84	115	146	176	207	237	268	299	327	358
9		24	55	85	116	147	177	208	238	269	300	328	359
10		25	56	86	117	148	178	209	239	270	301	329	360
11		26	57	87	118	149	179	210	240	271	302	330	361
12		27	58	88	119	150	180	211	241	272	303	331	362
13		28	59	89	120	151	181	212	242	273	304	332	363
14		29	60	90	121	152	182	213	243	274	305	333	364
15	0	30	61	91	122	153	183	214	244	275	306	334	365
16	1	31	62	92	123	154	184	215	245	276	307	335	
17	2	32	63	93	124	155	185	216	246	277	308	336	
18	3	33	64	94	125	156	186	217	247	278	309	337	
19	4	34	65	95	126	157	187	218	248	279	310	338	
20	5	35	66	96	127	158	188	219	249	280	311	339	
21	6	36	67	97	128	159	189	220	250	281	312	340	
22	7	37	68	98	129	160	190	221	251	282	313	341	
23	8	38	69	99	130	161	191	222	252	283	314	342	
24	9	39	70	100	131	162	192	223	253	284	315	343	
25	10	40	71	101	132	163	193	224	254	285	316	344	
26	11	41	72	102	133	164	194	225	255	286	317	345	
27	12	42	73	103	134	165	195	226	256	287	318	346	
28	13	43	74	104	135	166	196	227	257	288	319	347	
29	14	44	75	105	136	167	197	228	258	289		348	
30	15	45	76	106	137	168	198	229	259	290		349	
31		46		107	138		199		260	291		350	

- 1) Of the \$1,807 he paid for the third period, \$1,444 is applied to the underpayment remaining from the second period.
- 2) That leaves \$363 (\$1,807 – \$1,444) to apply to his third period required installment of \$1,529.
- 3) The result, \$1,166 (\$1,529 – \$363) is Ben's underpayment for the third period.

The \$1,166 underpayment is paid in two parts by applying his \$1,000 payment on January 10, 1997, and \$166 of his \$807 payment on January 15. On line 28, Ben shows each part of the underpayment paid on different dates.

Ben must figure the penalty using Rate Period 2 and Rate Period 3 as shown on Page 2 of Form 2210.

For **Rate Period 2**, the entire \$1,166 underpayment remained unpaid 107 days (September 16 through December 31, 1996). Ben enters "107" on line 32 and figures the penalty on line 33.

For **Rate Period 3**, \$1,000 of the underpayment remained unpaid 10 days (January 1, 1997 through January 10, 1997) and \$166 remained unpaid 15 days (January 1, 1997 through January 15, 1997). Ben enters those numbers on line 34 and figures his penalty for each part of the underpayment on line 35. He enters both penalty amounts on line 35.

**Penalty for fourth period (January 15, 1997) — column (d).** Ben figures his fourth period underpayment as follows:

- 1) Of the \$1,807 he paid for the fourth period, \$1,166 is applied to the underpayment remaining from the third period.
- 2) That leaves \$641 (\$1,807 – \$1,166) to apply to his fourth period required installment of \$1,529.
- 3) The result, \$888 (\$1,529 – \$641) is Ben's underpayment for the fourth period.

The \$888 underpayment was paid April 15, 1997, with his tax return. The \$888 remained unpaid 90 days (January 16 through April 15,

1997). Ben enters that number on line 34 and figures his penalty on line 35.

**Total penalty.** Ben's total penalty for 1996 on line 36 is \$92, the total of all amounts on lines 31, 33, and 35 in all columns. Ben enters that amount on line 63 of his Form 1040. He also adds \$92 to his \$1,803 tax balance and enters the \$1,895 total on line 62. He files his return on April 15 and includes a check for \$1,895. He keeps his completed Form 2210 for his records.

**Example 4.9.** In Example 4.7, Ben Brown's first underpayment was for the second payment period.

Ben's filled-in Schedule AI and Part IV of Form 2210 are shown at the end of this chapter. This example illustrates completion of Part IV, Section B, of Ben's Form 2210 under the annualized income installment method.

Ben made the same payments listed in the table in Example 4.8.

**Penalty for second period — column (b).** Ben's \$622 underpayment for the second payment period was paid by applying \$622 of

his \$1,000 August 30, 1996, payment. To help him figure his penalty, Ben shows the date the underpayment was paid on line 28.

Ben must figure the penalty using Rate Period 1 and Rate Period 2 as shown on Page 2 of Form 2210.

For **Rate Period 1**, the entire \$622 underpayment remained unpaid 15 days (June 16 through June 30, 1996). Ben enters "15" on line 30 and figures the penalty on line 31.

For **Rate Period 2**, the entire \$622 underpayment remained unpaid 61 days (July 1 through August 30, 1996). Ben enters "61" on line 32 and figures the penalty on line 33.

**Penalty for third period — column (c).** Ben's \$319 underpayment for the third payment period was paid by applying \$319 of his \$1,000 payment on January 10, 1997.

Ben must figure the penalty using Rate Period 2 and Rate Period 3 as shown on Page 2 of Form 2210.

For **Rate Period 2**, the entire \$319 underpayment remained unpaid 107 days (September 16 through December 31, 1996). Ben enters "107" on line 32 and figures the penalty on line 33.

For **Rate Period 3**, the entire \$319 underpayment remained unpaid 10 days (January 1, 1997 through January 10, 1997). Ben enters "10" on line 34 and figures the penalty on line 35.

**Penalty for fourth period — column (d).** Ben's \$888 underpayment for the fourth payment period was paid on April 15, 1997, with his tax return. The \$888 remained unpaid 90 days (January 16 through April 15, 1997). Ben enters that number on line 34 and figures his penalty on line 35.

**Total penalty.** Ben's total penalty for 1996 on line 36 is \$40, the total of all amounts on lines 31, 33, and 35 in all columns. Ben enters that amount on line 63 of his Form 1040. He also adds \$40 to his \$1,803 tax balance and enters the \$1,843 total on line 62. He files his return on April 15 and includes a check for \$1,843. Because he used the annualized income installment method, he **must** attach Form 2210, including Schedule AI, to his return and check the box on line 1b of Form 2210.

## Farmers and Fishermen

If you are a farmer or fisherman, the following special rules for underpayment of estimated tax apply to you.

- 1) The penalty for underpaying your 1996 estimated tax will not apply if you file your return and pay all the tax due by March 3, 1997. If you are a fiscal year taxpayer, the penalty will not apply if you file your return and pay the tax due by the first day of the third month after the end of your tax year.
- 2) Any penalty you owe for underpaying your 1996 estimated tax will be figured from one payment due date, January 15, 1997.

3) The underpayment penalty for 1996 is figured on the difference between the amount of 1996 withholding plus estimated tax paid by the due date and the smaller of:

- a) 100% of the tax shown on your 1995 return, or
- b) 66 $\frac{2}{3}$ % (rather than 90%) of your 1996 tax.

Even if these special rules apply to you, you will not owe the penalty if you meet either of the two conditions discussed earlier under *Exceptions*.

See Chapter 2 to see whether you are a farmer or fisherman who is eligible for these special rules.

**Form 2210-F.** Use Form 2210-F, *Underpayment of Estimated Tax by Farmers and Fishermen*, to figure any underpayment penalty. Do not attach it to your return unless you check box 1a or box 1b. Also, if neither box applies to you and you owe a penalty, you do not need to complete Form 2210-F. The IRS can figure your penalty and send you a bill. If you file your return by April 15 and pay the bill within 10 days after the notice date, the IRS will not charge you interest.

## Waiver of Penalty

The IRS can waive the penalty for underpayment if:

- 1) You did not make a payment because of a casualty, disaster, or other unusual circumstance and it would be inequitable to impose the penalty, or
- 2) You retired (after reaching age 62) or became disabled during the tax year a payment was due or during the preceding tax year, and both the following requirements are met:
  - a) You had a reasonable cause for not making the payment, and
  - b) Your underpayment was not due to willful neglect.



*Any penalty for an underpayment of either or both of the installments due April 15, 1996, and June 15, 1996, will be waived if the underpayment was caused by changes in the law made by the Small Business Job Protection Act of 1996. A list of changes that could cause an underpayment is at the beginning of this chapter under Important Changes for 1996.*

**How to request waiver.** To request a waiver, you **must** complete Form 2210 as follows.

- 1) Check the box on line 1a.
- 2) Complete line 2 through line 19 (or through line 35 if you use the regular method) without regard to the waiver.
- 3) Write the amount you want waived in parentheses on the dotted line next to line 20 (line 36 for the regular method).
- 4) Subtract this amount from the total penalty you figured without regard to the waiver. Enter the result on line 20 (line 36 for the regular method).
- 5) Attach Form 2210 and a statement to your return explaining the reasons you were unable to meet the estimated tax requirements and the time period for which you are requesting a waiver.
- 6) If you are requesting a penalty waiver due to a casualty, disaster, or other circumstance, include supporting documentation, such as police and insurance company reports.
- 7) If you are requesting a penalty waiver due to retirement or disability, attach documentation that shows your retirement date (and your age on that date) or the date you became disabled.

The IRS will review the information you provide and will decide whether or not to grant your request for a waiver.

**Farmers and fishermen.** To request a waiver, you **must** complete Form 2210-F as follows.

- 1) Check the box on line 1a.
- 2) Complete line 2 through line 17 without regard to the waiver.
- 3) Write the amount you want waived in parentheses on the dotted line next to line 18.
- 4) Subtract this amount from the total penalty you figured without regard to the waiver. Enter the result on line 18.
- 5) Attach Form 2210-F and a statement to your return explaining the reasons you were unable to meet the estimated tax requirements.
- 6) If you are requesting a penalty waiver due to a casualty, disaster, or other circumstance, include supporting documentation, such as police and insurance company reports.
- 7) If you are requesting a penalty waiver due to retirement or disability, attach documentation that shows your retirement date (and your age on that date) or the date you became disabled.

The IRS will review the information you provide and will decide whether or not to grant your request for a waiver.

**Underpayment of  
Estimated Tax by Individuals, Estates, and Trusts**

Department of the Treasury  
Internal Revenue Service

▶ Attach to Form 1040, 1040A, 1040NR, 1040NR-EZ, or 1041.

Name(s) shown on tax return

**Ivy Fields**

Identifying number

**222-00-2222**

**Note:** In most cases, you do not need to file Form 2210. The IRS will figure any penalty you owe and send you a bill. File Form 2210 only if one or more boxes in Part I apply to you. If you do not need to file Form 2210, you still may use it to figure your penalty. Enter the amount from line 20 or line 36 on the penalty line of your return, but do not attach Form 2210.

**Part I** **Reasons for Filing**—If 1a, b, or c below applies to you, you may be able to lower or eliminate your penalty. But you **MUST** check the boxes that apply and file Form 2210 with your tax return. If 1d below applies to you, check that box and file Form 2210 with your tax return.

- 1 Check whichever boxes apply (if none apply, see the Note above):
  - a  You request a waiver. In certain circumstances, the IRS will waive all or part of the penalty. See Waiver of Penalty on page 2 of the instructions. -
  - b  You use the annualized income installment method. If your income varied during the year, this method may reduce the amount of one or more required installments. See page 4 of the instructions.
  - c  You had Federal income tax withheld from wages and, for estimated tax purposes, you treat the withheld tax as paid on the dates it was actually withheld, instead of in equal amounts on the payment due dates. See the instructions for line 22 on page 3.
  - d  Your required annual payment (line 13 below) is based on your 1995 tax and you filed or are filing a joint return for either 1995 or 1996 but not for both years.

**Part II** **Required Annual Payment**

**Example 4.4**

2	Enter your 1996 tax after credits (see page 2 of the instructions)	2	11,000
3	Other taxes (see page 2 of the instructions)	3	
4	Add lines 2 and 3	4	11,000
5	Earned income credit	5	
6	Credit for Federal tax paid on fuels	6	
7	Add lines 5 and 6	7	
8	Current year tax. Subtract line 7 from line 4	8	11,000
9	Multiply line 8 by 90% (.90)	9	9,900
10	Withholding taxes. Do not include any estimated tax payments on this line (see page 2 of the instructions)	10	1,600
11	Subtract line 10 from line 8. If less than \$500, stop here; do not complete or file this form. You do not owe the penalty	11	9,400
12	Enter the tax shown on your 1995 tax return (110% of that amount if the adjusted gross income shown on that return is more than \$150,000, or if married filing separately for 1996, more than \$75,000). Caution: See page 2 of the instructions	12	10,000
13	Required annual payment. Enter the smaller of line 9 or line 12	13	9,900

**Note:** If line 10 is equal to or more than line 13, stop here; you do not owe the penalty. Do not file Form 2210 unless you checked box 1d above.

**Part III** **Short Method** (Caution: See page 2 of the instructions to find out if you can use the short method. If you checked box 1b or c in Part I, skip this part and go to Part IV.)

**Example 4.5**

14	Enter the amount, if any, from line 10 above	14	1,600
15	Enter the total amount, if any, of estimated tax payments you made	15	6,800
16	Add lines 14 and 15	16	8,400
17	Total underpayment for year. Subtract line 16 from line 13. If zero or less, stop here; you do not owe the penalty. Do not file Form 2210 unless you checked box 1d above	17	1,500
18	Multiply line 17 by .05914	18	89
19	<ul style="list-style-type: none"> <li>• If the amount on line 17 was paid on or after 4/15/97, enter -0-</li> <li>• If the amount on line 17 was paid before 4/15/97, make the following computation to find the amount to enter on line 19.</li> </ul>	19	12
20	<b>PENALTY.</b> Subtract line 19 from line 18. Enter the result here and on Form 1040, line 63; Form 1040A, line 34; Form 1040NR, line 63; Form 1040NR-EZ, line 26; or Form 1041, line 26	20	77



**Schedule AI—Annualized Income Installment Method** (see pages 4 and 5 of the instructions)

Estates and trusts, do not use the period ending dates shown to the right. Instead, use the following: 2/29/96, 4/30/96, 7/31/96, and 11/30/96.

	(a) 1/1/96-3/31/96	(b) 1/1/96-6/31/96	(c) 1/1/96-9/31/96	(d) 1/1/96-12/31/96
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**Part I Annualized Income Installments** Caution: Complete lines 20-26 of one column before going to the next column.

- 1 Enter your adjusted gross income for each period (see instructions). (Estates and trusts, enter your taxable income without your exemption for each period.) . . . . .
- 2 Annualization amounts. (Estates and trusts, see instructions.) . . . . .
- 3 Annualized income. Multiply line 1 by line 2 . . . . .
- 4 Enter your itemized deductions for the period shown in each column. If you do not itemize, enter -0- and skip to line 7. (Estates and trusts, enter -0-, skip to line 9, and enter the amount from line 3 on line 9.)
- 5 Annualization amounts . . . . .
- 6 Multiply line 4 by line 5 (see instructions if line 3 is more than \$58,975)
- 7 In each column, enter the full amount of your standard deduction from Form 1040, line 34, or Form 1040A, line 19 (Form 1040NR or 1040NR-EZ filers, enter -0-. Exception: Indian students and business apprentices, enter standard deduction from Form 1040NR, line 33 or Form 1040NR-EZ, line 10.) . . . . .
- 8 Enter the larger of line 6 or line 7. . . . .
- 9 Subtract line 8 from line 3 . . . . .
- 10 In each column, multiply \$2,550 by the total number of exemptions claimed (see instructions if line 3 is more than \$88,475). (Estates and trusts and Form 1040NR or 1040NR-EZ filers, enter the exemption amount shown on your tax return.) . . . . .
- 11 Subtract line 10 from line 9 . . . . .
- 12 Figure your tax on the amount on line 11 (see instructions) . . . . .
- 13 Form 1040 filers only, enter your self-employment tax from line 35 below . . . . .
- 14 Enter other taxes for each payment period (see instructions) . . . . .
- 15 Total tax. Add lines 12, 13, and 14 . . . . .
- 16 For each period, enter the same type of credits as allowed on Form 2210, lines 2, 5, and 6 (see instructions)
- 17 Subtract line 16 from line 15. If zero or less, enter -0- . . . . .
- 18 Applicable percentage . . . . .
- 19 Multiply line 17 by line 18 . . . . .
- 20 Add the amounts in all preceding columns of line 25 . . . . .
- 21 Subtract line 20 from line 19. If zero or less, enter -0- . . . . .
- 22 Enter 1/4 of line 13 on page 1 of Form 2210 in each column . . . . .
- 23 Enter amount from line 25 of the preceding column of this schedule
- 24 Add lines 22 and 23 and enter the total . . . . .
- 25 Subtract line 21 from line 24. If zero or less, enter -0- . . . . .
- 26 Enter the smaller of line 21 or line 24 here and on Form 2210, line 21 . . . . .

1	5,250	13,025	21,993	36,427
2	4	2.4	1.5	1
3	21,000	31,260	32,990	36,427
4	1,500	2,500	4,000	6,000
5	4	2.4	1.5	1
6	6,000	6,000	6,000	6,000
7	4,000	4,000	4,000	4,000
8	6,000	6,000	6,000	6,000
9	15,000	25,260	26,990	30,427
10	2,550	2,550	2,550	2,550
11	12,450	22,710	24,440	27,877
12	1,871	3,409	3,719	4,685
13		1,560	1,822	2,346
14				
15	1,871	4,969	5,541	7,031
16				
17	1,871	4,969	5,541	7,031
18	22.58	458	67.58	908
19	421	2,236	3,740	6,328
20		421	2,236	3,740
21	421	1,815	1,504	2,588
22	1,529	1,529	1,529	1,529
23		1,108	822	847
24	1,529	2,637	2,351	2,376
25	1,108	822	847	
26	421	1,815	1,504	2,376

**Part II Annualized Self-Employment Tax**

- 27a Net earnings from self-employment for the period (see instructions)
- b Annualization amounts . . . . .
- c Multiply line 27a by line 27b . . . . .
- 28 Social security tax limit . . . . .
- 29 Enter actual wages subject to social security tax or the 6.2% portion of the 7.65% railroad retirement (tier 1) tax . . . . .
- 30 Annualization amounts . . . . .
- 31 Multiply line 29 by line 30 . . . . .
- 32 Subtract line 31 from line 28. If zero or less, enter -0- . . . . .
- 33 Multiply the smaller of line 27c or line 32 by .124 . . . . .
- 34 Multiply line 27c by .029 . . . . .
- 35 Add lines 33 and 34. Enter the result here and on line 13 above ▶

27a		4,248	7,943	15,330
27b	4	2.4	1.5	1
27c		10,195	11,913	15,330
28	\$62,700	\$62,700	\$62,700	\$62,700
29		8,750	14,000	21,000
30	4	2.4	1.5	1
31		21,000	21,000	21,000
32		41,700	41,700	41,700
33		1,264	1,477	1,901
34		296	345	445
35		1,560	1,822	2,346

**Part IV Regular Method** (See page 2 of the instructions if you are filing Form 1040NR or 1040NR-EZ.)

**Section A—Figure Your Underpayment**

		Payment Due Dates			
		(a) 4/15/96	(b) 6/15/96	(c) 9/15/96	(d) 1/15/97
21	Required installments. If box 1b applies, enter the amounts from Schedule AI, line 26. Otherwise, enter 1/4 of line 13, Form 2210, in each column . . . . .	421	1,815	1,504	2,376
22	Estimated tax paid and tax withheld (see page 3 of the instructions). For column (a) only, also enter the amount from line 22 on line 26. If line 22 is equal to or more than line 21 for all payment periods, stop here; you do not owe the penalty. Do not file Form 2210 unless you checked a box in Part I . . . . . <i>Complete lines 23 through 29 of one column before going to the next column.</i>	807	807	1,807	1,807
23	Enter amount, if any, from line 29 of previous column		386		
24	Add lines 22 and 23 . . . . .		1,193	1,807	1,807
25	Add amounts on lines 27 and 28 of the previous column . . . . .			622	319
26	Subtract line 25 from line 24. If zero or less, enter -0-. For column (a) only, enter the amount from line 22 . . . . .	807	1,193	1,185	1,488
27	If the amount on line 26 is zero, subtract line 24 from line 25. Otherwise, enter -0- . . . . .		-0-	-0-	
28	Underpayment. If line 21 is equal to or more than line 26, subtract line 26 from line 21. Then go to line 23 of next column. Otherwise, go to line 29 . . . ▶		8/30 622	1/10 319	888
29	Overpayment. If line 26 is more than line 21, subtract line 21 from line 26. Then go to line 23 of next column	386			

**Section B—Figure the Penalty** (Complete lines 30 through 35 of one column before going to the next column.)

		4/15/96	6/15/96	9/15/96	1/15/97
Rate Period 1 April 16, 1996—June 30, 1996	30 Number of days FROM the date shown above line 30 TO the date the amount on line 28 was paid or 6/30/96, whichever is earlier . . . . .	Days:	Days:		
	31 Underpayment on line 28 (see page 4 of the instructions) × $\frac{\text{Number of days on line 30}}{366}$ × .08 ▶		15		
Rate Period 2 July 1, 1996—December 31, 1996	32 Number of days FROM the date shown above line 32 TO the date the amount on line 28 was paid or 12/31/96, whichever is earlier . . . . .	Days:	Days:	Days:	
	33 Underpayment on line 28 (see page 4 of the instructions) × $\frac{\text{Number of days on line 32}}{366}$ × .09 ▶		61	107	
Rate Period 3 January 1, 1997—April 15, 1997	34 Number of days FROM the date shown above line 34 TO the date the amount on line 28 was paid or 4/15/97, whichever is earlier . . . . .	Days:	Days:	Days:	Days:
	35 Underpayment on line 28 (see page 4 of the instructions) × $\frac{\text{Number of days on line 34}}{365}$ × .09 ▶			10	90
36	<b>PENALTY.</b> Add all amounts on lines 31, 33, and 35 in all columns. Enter the total here and on Form 1040, line 63; Form 1040A, line 34; Form 1040NR, line 63; Form 1040NR-EZ, line 26; or Form 1041, line 26 . . . . . ▶			\$ 1	\$ 20
					36 \$ 40

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## How To Get More Information



You can get help from the IRS in several ways.

**Free publications and forms.** To order free publications and forms, call 1-800-TAX-FORM (1-800-829-3676). You can also write to the IRS Forms Distribution Center nearest you. Check your income tax package for the address. Your local library or post office also may have the items you need.

For a list of free tax publications, order Publication 910, *Guide to Free Tax Services*. It also contains an index of tax topics and related publications and describes other free tax information services available from IRS, including tax education and assistance programs.

If you have access to a personal computer and modem, you also can get many forms and

publications electronically. See *Quick and Easy Access to Tax Help and Forms* in your income tax package for details. If space permitted, this information is at the end of this publication.

**Tax questions.** You can call the IRS with your tax questions. Check your income tax package or telephone book for the local number, or you can call 1-800-829-1040.

**TTY/TDD equipment.** If you have access to TTY/TDD equipment, you can call 1-800-829-4059 to ask tax questions or to order forms and publications. See your income tax package for the hours of operation.

